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BALANCE SHEETS

HOW TO READ AND
UNDERSTAND THEM

BALANCE SHEETS

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A GUIDE FOR INVESTORS, BUSINESS MEN, COMMERCIAL STUDENTS, ETC.

BY THE LATE
PHILIP TOVEY

FOURTH EDITION

By
F. CLIVE de PAULA, T.D., A.C.A., F.C.W.A.

LONDON
SIR ISAAC PITMAN & SONS, LTD.

First published 1920
Third edition 1937
Reprinted 1938
Reprinted 1941
Reprinted 1942
Reprinted 1946
Reprinted 1948
Fourth edition 1954
Reprinted 1955
Reprinted 1956

SIR ISAAC PITMAN & SONS, LTD.
PITMAN HOUSE, PARKER STREET, KINGSWAY, LONDON, W.C.2
THE PITMAN PRESS, BATH
PITMAN HOUSE, BOUVERIE STREET, CARLTON, MELBOURNE
27 BECKETTS BUILDINGS, PRESIDENT STREET, JOHANNESBURG

ASSOCIATED COMPANIES
PITMAN MEDICAL PUBLISHING COMPANY, LTD.
45 NEW OXFORD STREET, LONDON, W.C.1
PITMAN PUBLISHING CORPORATION
2 WEST 45TH STREET, NEW YORK
SIR ISAAC PITMAN & SONS (CANADA), LTD.
(INCORPORATING THE COMMERCIAL TEXT BOOK COMPANY)
PITMAN HOUSE, 381-383 CHURCH STREET, TORONTO

MADE IN GREAT BRITAIN AT THE PITMAN PRESS, BATH
E6—(B.1569)

PREFACE
TO THE FOURTH EDITION

SINCE the late Mr. Philip Tovey wrote this book, the Companies Act of 1948 has made sweeping changes in the content and layout of published balance sheets. In amending the text and the examples so as to bring them into line with the 1948 Act, no attempt has been made to change the style and content of the book, which were set by the late Mr. Tovey when he wrote the following Preface.

PREFACE
TO THE FIRST EDITION

THIS little book is not intended for skilled accountants or professional financiers, but primarily for that large and increasing body of men and women who have adventured their capital in joint-stock undertakings and who desire to find some basis other than mere guesswork whereby they may estimate the safety and value of their investments. Secondarily, it is hoped it may be of service to the numerous creditors of joint-stock companies which today have replaced to so large an extent the old-fashioned trading firms of fifty years ago.

It is safe to say that to the majority of these two classes the balance sheet is a distracting puzzle. They find the form unfamiliar and the terms confusing. They cannot mentally trace, as can the practised accountant, the previous evolution of the items which appear in the accounts, and yet it is frequently vital to their interests that they should do so.

It is not pretended that the hints given in the following pages will fill all the gaps in the investor's experience which systematic and close study alone would supply, but an endeavour has been made by means of numerous examples from actual balance sheets to accustom the student-investigator to seize upon salient features and to turn a critical eye upon points of weakness.

In addition, an attempt has been made to indicate the lines upon which a thorough and searching examination should be conducted, and the method suggested has been adopted by the writer as a result of the study of thousands of balance sheets.

One word of caution should, perhaps, be added, namely, that before taking the serious risks involved in the investment of capital, the investor should invariably fortify his own judgment by the opinion of a skilled critic of finance and of accounts, but he might profitably bear in mind that no adviser's recommendation should unreservedly be accepted unless it be based upon a real knowledge of the facts obtainable from the balance sheet.

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CHAPTER I

WHAT IS A BALANCE SHEET?

THE object of the author in writing this book is to enable the reader to grasp without difficulty the salient features of the modern balance sheet. The importance of readily understanding the summarized statement of the affairs of a public company, or of a private firm, will be denied by none. The man of business, who desires to estimate for himself the stability of his customers, the capitalist who proposes to enter into a commercial partnership with an existing firm, the investor who has acquired, or thinks of acquiring, shares or debentures in a trading corporation, and the accountant whose duty it is to understand all that pertains to the accounts he controls, should be able to extract from a balance sheet the essential information he requires, or, failing that, to frame such a series of searching questions as will result in laying bare the facts behind the figures.

Balance sheets are not, as a rule, simple lists of assets and liabilities which he who runs may read; on the contrary, they are often financial statements of exceeding intricacy which baffle the ordinary person and yield their secrets only to the trained mind. But whilst nothing save long experience in the handling of balance sheets can evolve that faculty which enables the expert almost instinctively to detect the weak points in the statements placed before him, it is hoped that sufficient suggestions may be imparted to the alert-minded reader to enable him fairly to judge from the balance sheet the real position of undertakings in which he is or may be interested.

Definition of Balance Sheet

In the first place, what is a balance sheet? There are various definitions, but the most correct appears to be that which describes it broadly as a statement showing the financial position of a concern, by means of debtor and creditor balances at a given date. These debtor and creditor balances are, of course, those remaining after all the revenue items have been transferred to trading account and profit and loss account, this latter itself being treated as a balance. As the books of account contain entries other than those directly pertaining to assets and liabilities, it will be obvious to the student why items wholly dissimilar from assets and liabilities appear in most balance sheets. But to the reader having no acquaintance

Example 1.—Some Fictitious Assets

BALANCE SHEET. 31ST MARCH, 19..

Corresponding figures for last year £	£		£	£
xx,xxx		Share Capital, Authorized and Issued— 80,000 Shares of £1 each, fully paid		80,000
		Debenture Capital—		
	xx,xxx	6% Prior Lien Debenture Stock (Redeemable out of profits at £105 %)	24,692	
	xx,xxx	434 6% First Debentures of £100 each (Redeemable at £105%)	43,400	
	xxx,xxx	1,000 8% Second Debentures of £100 each (Redeemable at £105 %)	100,000	
xxx,xxx				168,092
		Debenture Interest Account— Interest accrued to date—Prior Lien Debenture Stock (Gross)		
	xxx		136	
	x,xxx	6% First Debentures (Gross)	1,953	
	x,xxx	8% Second Debentures (Gross)	5,644	
x,xxx				7,733
		CURRENT LIABILITIES Overdraft at Bankers—		
	x,xxx	In London	1,169	
	xxx	In Chile	9,253	
x,xxx				10,422
		Sundry Creditors, including Cash Advances—		
	x,xxx	In London	3,694	
	x,xxx	In Chile	9,139	
xx,xxx				12,833
£xxx,xxx				£279,080

	£	£	Corresponding figures for last year £	£
FIXED ASSETS Nitrate Grounds, at cost, as per last Balance Sheet	70,000		xx,xxx	
Cost of Works and expenditure in relation thereto, as per last Balance Sheet	126,049		xxx,xxx	
Cost of additional work during the year	473		xxx	
		196,522		xxx,xxx
Motor Vehicles at Cost	5,500		x,xxx	
Less Depreciation to date	1,036		x,xxx	
		4,464		x,xxx
House and Office Furniture, in Chile, at cost	1,200		x,xxx	
Less Depreciation to date	232		xxx	
		968		xxx
		201,954		xxx,xxx
CURRENT ASSETS General Stores, Pulperia, Coal, etc., as per inventories, at cost	8,229		x,xxx	
Caliche in Stock, at cost	1,163		x,xxx	
Nitrate in Stock, at prices since realized after allowing for charges and duties to be paid	13,173		xx,xxx	
	22,565		xx,xxx	
Sundry Debtors—in London	22		xxx	
in Chile	526		xxx	
Cash at Bankers and in hand—in London	1,545		x,xxx	
in Chile	4,249		xxx	
		28,907		xx,xxx
Expenses of Debenture Issues (including Underwriting Commission on Debentures £7,500) as per last Balance Sheet	8,761		x,xxx	
Expenses during year to date	76		xx	
		8,837		x,xxx
Expenses in London to 31st March, 19.., including Debenture Interest and Administration Expenses, as per last Balance Sheet		18,214		xx,xxx
Profit and Loss Account— **Loss for the year to 31st March, 19.., per annexed account**		21,168		xx,xxx
		£279,080		£xxx,xxx

with the actual book-keeping behind the published accounts, it will not be so clear. He certainly will be puzzled by the fact that where he expected to find two columns of clearly set out items, one representing properties and possessions and the other representing amounts owing, he discovers, in addition, various entries on both sides which are neither things possessed nor liabilities which have accrued.

Fictitious Assets

For instance, on the "Assets" side there may appear "Preliminary Expenses" representing the cost of forming, registering, and floating a new company, or an amount showing the cost of issuing debentures to the public—and sometimes a sum equal to the discount which has been allowed to the purchasers of the said debentures—items which by no stretch of imagination can be regarded as "assets." For specimens of these let the reader refer to Example 1. Again, on the "liabilities" side will be found the share capital of a limited company, which is certainly not a trading debt, and, if fully paid, does not concern the creditors at all; and there may be seen sundry "reserves" which in no circumstances could ever be liabilities in the ordinary sense. As a matter of fact, there are good reasons for these apparent anomalies, but it is not proposed to enter upon a detailed explanation of them here. There will be occasion to illustrate these points later, when their meaning and value are under consideration.

In view of the importance of the balance sheet to the merchant and the investor, it might at least be expected that its contents would be set out in a scrupulously clear and detailed form, but this is by no means common. There is no standard balance sheet in general use, by means of which the public can compare the financial position of one concern with another, and, where special forms of accounts have been imposed by statute, as in the case of assurance companies, waterworks, etc., the results have not given unmitigated satisfaction. The British legislature has ever shown a laudable intention to interfere as little as possible with the accounts which public companies present to their members, and, in fact, until the coming into force of the Companies Act of 1907 (now embodied in the Companies Act, 1948), there was no enforceable statutory obligation upon a limited company to produce a balance sheet at all, unless such were provided for by the company's articles of association.

Legal Requirements

The law, however, is now more strict in that respect, and each Public Limited Company formed under the Companies Act must

file annually a copy of its balance sheet and profit and loss account at Bush House, Aldwych, London, W.C.2, where it may be inspected by any interested person. Of course, no private firm or individual is compelled to *publish* a balance sheet, or even prepare one—except that in practice the income tax authorities often demand this, in addition to a statement of profit, in support of the income tax return.

The point of interest at the moment is that this balance sheet and profit and loss account required by the authorities must "give a true and fair view of the state of affairs of the company as at the end of its financial year, and every profit and loss account of a company shall give a true and fair view of the profit or loss of the company for the financial year." In addition, the Companies Act, 1948, sets out in considerable detail exactly what particulars must be disclosed in these published accounts regarding the assets and liabilities of the business, and regarding items entering into the profit and loss account. Prior to this significant step on the part of the legislature, it should be noted that the desirable "particulars" now required to be filed were not always supplied on the balance sheet placed before the shareholder. By the Act of 1948 this secretiveness is somewhat diminished.

Function of Balance Sheet

If there were any reasonable doubt as to the function the balance sheet is intended to fulfil, it would be more easy to understand the lack of clarity and of information which so frequently characterizes these statements. But no doubt whatsoever exists. Without question, the intention is to afford the shareholder who has placed his capital in a concern, and the creditor who does business with it, an opportunity of estimating from time to time its financial stability. The recognition of this fact by the coded law gives point and force to the common view. Those who risk their money have the right to know that it is being judiciously employed, and if such knowledge be withheld there should be cogent reasons for the silence. Many directors appear to object, possibly from sheer conservatism, to the publication of more than the barest facts concerning the companies they control, and corporations which have done a flourishing business for years, and have paid handsome dividends to the proprietors, often, prior to the passing of the previous Companies Act in 1929, used to lump together their entire assets in a few huge totals, which completely defeated any attempt to estimate their financial condition. To make the matter clear, we give on page 5 a specimen of this form of balance sheet, which, except for a few

slight alterations, is based on the published accounts of a well-known and flourishing trading concern issued prior to the coming into force of the Companies Act of 1929. It must be emphasized that the 1929 Companies Act would have made such a degree of secrecy impossible, and under the 1948 Act even greater disclosure would be required.

Secretive Balance Sheet

Here, on the "Assets" side, twelve items, distinct in their nature, are valued at an enormous total, but the figures are quite worthless to the financial critic. He cannot even obtain an approximate idea of the value of the assets. For instance, how much of the sum of £575,000 does goodwill absorb? What are the respective values of freehold and leasehold land? Investigation is baffled at the outset. Again, the amount of £1,125,000 may practically all be represented by stock, which a bad season might render unsaleable; or it may consist, in an abnormal degree, of outstanding debts difficult of collection. The loans may be secured, or unsecured, and for a large or a small amount; investments may be a big or an insignificant item, and they may be marketable or otherwise.

Example 2.—A Secretive Balance Sheet

Liabilities	£	Assets	£
Share Capital—		Goodwill, Freehold and Leasehold Land, Buildings, Machinery and Plant	575,000
500,000 Preference Shares of £1 each, fully paid	500,000	Stock-in-Trade, Trade Debtors, Bills Receivable, Loans, Investments, Cash at Bankers and in hand .	1,125,000
500,000 Ordinary Shares of £1 each, fully paid	500,000		
4½% First Mortgage Debentures . . .	100,000		
Trade and other creditors . . .	315,000		
Reserve Account . .	175,000		
Profit and Loss Account	110,000		
	£1,700,000		£1,700,000

In fact, in balance sheets of this type, there was usually only one item which gave any clue to the state of affairs, and that was the profit and loss account, but even this might be set out in a totally misleading fashion. Thus, in the balance sheet shown above it was impossible to say whether the sum of £110,000 at the foot of the left-hand column represented the profit of the current year, whether it was a sum brought forward from last year, or a balance after paying dividends. As a rule, while a company pays good dividends,

Example 3.—Compara

Balance Sheet. 31st

Corresponding figures for last year £	£			
		CAPITAL AND RESERVES		
		Authorized Capital—		
	xxx,xxx	90,000 Cumulative 6% Preference Shares of £5 each .	450,000	
	xxx,xxx	200,000 Cumulative 6% B Preference Shares of £1 each	200,000	
	xxx,xxx	625,000 Ordinary Shares of £1 each	625,000	
	x,xxx,xxx		1,275,000	
		Issued Capital—		
	xxx,xxx	90,000 Cumulative 6% Preference Shares of £5 each, fully paid	450,000	
	xxx,xxx	200,000 Cumulative 6% B Preference Shares of £1 each, fully paid	200,000	
	xxx,xxx	625,000 Ordinary Shares of £1 each, fully paid . .	625,000	
	x,xxx,xxx		1,275,000	
	xxx	*Less* Calls unpaid on New Issue of Ordinary Shares .	164	
x,xxx,xxx				1,274,836
		Revenue Reserve Fund—		
	xxx,xxx	Balance at 31st December, 19...	209,713	
	—	Transferred from Profit and Loss Account at 31st December, 19..	5,000	
	x,xxx	Income on Investments for the year	4,215	
	xxx,xxx		218,928	
	x,xxx	*Less* Depreciation in value of quoted Investments .	1,638	
xxx,xxx				217,290
xx,xxx		Reserve for future taxation		70,164
xx,xxx		Profit and Loss Account, balance carried forward . .		29,969
x,xxx,xxx				1,592,259
		MORTGAGES AND SECURED LOANS		
	xxx,xxx	**Loans Secured** or partly secured by deposit of Warrants for Stock and other Securities	120,156	
	x,xxx	**Liability on Mortgage** of Land and Buildings acquired subject thereto	3,560	
xxx,xxx				123,716
		CURRENT LIABILITIES		
	xxx,xxx	**Unsecured Loans**	261,611	
	xx,xxx	**Bills Payable**	156,212	
	xxx,xxx	**Sundry Creditors**	221,298	
	xx,xxx	Provision for Current Taxation	103,201	
	xx,xxx	Provision for Preference Dividends (net)	10,238	
	xx,xxx	Proposed Ordinary Dividend (net)	32,813	
xxx,xxx				785,373
		Contingent Liability upon Bills discounted including Bankers' Acceptances and Bills drawn against Securities and Documents, £371,468.		
£x,xxx,xxx				£2,501,348

tively Full Details

DECEMBER, 19..

				Comparative figures for last year	
				£	£
FIXED ASSETS					
Goodwill Account, at cost			656,463		xxx,xxx
Freehold Land, at cost			52,630		xx,xxx
Buildings, at cost		250,000		xxx,xxx	
Less Depreciation to date		51,623		xx,xxx	
			198,377		xxx,xxx
Plant, Machinery and Tools, at cost		150,000		xxx,xxx	
Less Depreciation to date		32,997		xx,xxx	
			117,003		xxx,xxx
Motor Vehicles, Office Furniture, at cost		20,000		xx,xxx	
Less Depreciation to date		8,170		x,xxx	
			11,830		xx,xxx
Trade Investments, at cost		146,866		xxx,xxx	
Less Amounts written off		16,129		xx,xxx	
(Some of these are lodged as security against Loans and for payment of Customs Duties, etc.)			130,737		xxx,xxx
			1,167,040		x,xxx,xxx
CURRENT ASSETS					
Revenue Fund Investments—					
4% Consols, at cost		21,795		xx,xxx	
Less Depreciation (to reduce to Market Value)		1,638		x,xxx	
		20,157		xx,xxx	
Mortgages, at cost		11,487		xx,xxx	
Freehold Land and Buildings at Rotterdam, at cost		83,842		xx,xxx	
			115,486		xxx,xxx
Stocks of Raw Material and Manufactured Goods as certified by the Company Officials. (Exclusive of Raw Materials purchased but not delivered.)		328,523		xxx,xxx	
Stocks of Stores, Packages, etc., as certified by the Company's Officials		55,859		xx,xxx	
Bills Receivable in Hand		31,077		xx,xxx	
Sundry Debtors	761,201				
Less Reserve for Doubtful Debts	60,638				
		700,563		xxx,xxx	
Money on Loan at call		6,951		x,xxx	
Cash at Bankers and in hand		80,634		xx,xxx	
			1,203,607		x,xxx,xxx
Development expenditure on New Products including Advertising and works expenditure, at cost		35,764		xx,xxx	
Less Amounts written off		20,549		xx,xxx	
			15,215		xx,xxx
			£2,501,348		£x,xxx,xxx

shareholders are content, and creditors have no fears; it is only when dividends are reduced, or suddenly cease altogether, that a spirit of inquiry is manifested, and the balance sheet and profit and loss account become the object of anxious scrutiny.

Suppression of Details

It was commonly urged that details were suppressed in order to conceal facts of vital business importance from trade rivals, and in special instances the force of this is not denied. In the majority of cases, however, the figures which are of value to commercial opponents are not balance sheet items at all, but those which relate to revenue, and have to do with trade turnover, margin of profit, cost of manufacture, and sources of income and expenditure. But, in general, no company which is soundly managed has anything to fear from publication in its balance sheet and profit and loss account of the information required under the Companies Act, 1948, and there can be no doubt that the policy of frankness is infinitely more acceptable to those who are financially interested in the welfare of the enterprise. In fact, some companies disclose even more information than is required by the 1948 Act. They also show in their profit and loss account such figures as the total turnover for the year, cost of sales, profit margin, etc. No doubt they feel that the information sought by competitors is to be found, not in published accounts that record past history, but in the competitive market which they are each trying to capture in the future.

Detailed Balance Sheet

Let the reader now glance at the accompanying balance sheet of another important and successful trading company (Example 3). It is introduced solely for the purpose of contrasting its comparative generosity of detail with the meagreness of the previous example.

It will be noticed that on the assets side there is no "lumping" of dissimilar items, but that each is separately set out. The result is that the total of two and a half million pounds of assets can be fairly analysed. The fixed capital items such as land, buildings, plant and machinery are individually shown; sundry debtors (*less* the amount provided for doubtful debts) and stocks of materials are stated separately; the liquid assets—such as bills receivable and cash—are clearly displayed; trade investments are separated from reserve fund investments; and, finally, the first and last items, representing goodwill and expenditure on advertising respectively, are openly set forth, instead of being confusedly mixed up with the tangible properties.

On the liabilities side there is also a commendable amount of detail, the actual indebtedness of the company (printed in heavier type) being given under the headings (1) Bills Payable; (2) Sundry Creditors; (3) Unsecured Loans; (4) Loans for which securities have been deposited; and (5) Liability on Mortgage. The result is that the initial difficulties in the way of investigation are considerably reduced, and the particulars supplied are sufficient to enable at least a fair estimate of the company's actual financial position to be formed.

CHAPTER II

THE MAIN STRUCTURE OF CAPITAL AND ASSETS

WE must now consider the balance sheet in detail. So far as form is concerned, it is usual to place the Assets and the Liabilities on the right- and left-hand sides respectively of the balance sheet, but some companies, particularly in Scotland and America, reverse this order, and a large number of American companies merely set out the liabilities under the assets, and extend the two totals. Of this form the balance sheet shown in Example 4 is a very simple one.

Example 4.—An American Style

BALANCE SHEET, 15TH FEBRUARY, 19..

ASSETS		
Investments in other Companies	$92,083,965.55	
Cash	200,200.81	
		$92,284,166.36
LIABILITIES		
Preferred Shares issued	$50,000,000.00	
Common Shares issued	41,380,400.00	
Surplus	903,766.36	
		$92,284,166.36

In discussing the various items, it is proposed to consider, first, the capital account, for that is the foundation of the business; then to discuss the assets—the possessions which capital enables the company or trader to acquire; and, lastly, to consider the liabilities—the debts incurred in the course of trading.

The capital account of a joint-stock company will always be found on the liabilities side of the balance sheet. The reason is, of course, that as the capital is supplied by the owners, the latter—as between the business and themselves—are regarded as creditors of the company. The shareholders of a limited company certainly are creditors, but, perhaps with the exception of holders of Redeemable Preference shares, they have no claim upon their invested capital, or any portion of it, until the company has gone into liquidation, and has paid off every debt incurred to third parties.

Capital and Assets

It is obvious, however, that the capital of the business must appear on the opposite side to that of the assets, for it is that which

purchases the assets. The accompanying balance sheet (Example 5) represents the position of a supposititious company about to commence business, after having employed its capital in the purchase of sundry assets.

Example 5.—Invested Capital Represented by Assets

BALANCE SHEET, 1ST JANUARY, 19..

LIABILITIES	£	ASSETS	£
Capital—		Freehold Premises . .	40,000
100,000 Ordinary Shares of £1 each, 10s. paid .	50,000	Plant and Machinery .	15,000
50,000 5% Preference Shares, £1 each, fully paid	50,000	Stocks of Material . .	25,000
		Cash	20,000
	£100,000		£100,000

From this simple illustration it will be seen that, of the capital raised, £80,000 was used to purchase various assets and £20,000 was retained in cash for working capital, the whole of the £100,000 being thus accounted for. Precisely the same form might be used for the balance sheet of a private firm, except that the name of the proprietor would appear in place of the word capital, and the division of the capital into shares would not be shown.

Capital Accounts—Liability of Shareholders

There are, however, some noteworthy differences between the capital account of a public company and that of a private trader. In the first place, assuming that the company has been duly registered as a limited liability company under the Companies Act, the liability of the shareholder is limited to the nominal value of the shares held by him. If these be fully paid, however deeply the company may become involved in debt, the shareholder cannot be called upon to make good the liabilities. The creditors may seize the property, or the company may be put into liquidation, with the result that the shareholder may, in the end, lose all he has invested in the unfortunate concern, but his loss rests there. The private trader, on the contrary, not only stands to lose the capital he originally invested, but he must meet his creditors' demands, if needs be, with his whole fortune. Hence the capital account of the public company needs careful study both by the intending investor and by the creditor, although they approach its consideration from very different points of view.

The creditor, naturally, will concern himself almost exclusively with the amount of the liabilities which can be enforced against the company.

Liability on Uncalled Capital

In the supposititious balance sheet given on page 11, only 10s. per share has been paid up on the 100,000 Ordinary shares which have been issued, so that a liability of a further 10s. per share remains. The company may call this up whenever they require it, either for purposes of development or for the payment of creditors. Whoever purchases any of these shares takes over the liability attached thereto, and this fact should never be forgotten, even when the concern has had, to all appearances, a prosperous career. Many cases are on record in which companies have been forced into liquidation and the liquidator has been compelled to call up the balance outstanding on partly-paid share capital, to the utter dismay of the holders.

In this connection it is worth noting that in a liquidation any person, who has been a shareholder within 12 months of the winding-up, may be called upon to pay the unpaid amount if the person to whom he sold the shares defaults, although only such an amount may be demanded of him as is proportionate to the debts of the company at the date of his ceasing to be a member.

For instance, early in 1909, the Law Guarantee Trust and Accident Society was suspected of being in difficulties. On its £10 shares (nominal value) only £1 had been paid, so that there was a total liability of £9 per share outstanding. Shortly afterwards a call of £2 per share was made, and the shares became practically unsaleable. Further amounts were subsequently called up, and the company went into liquidation. On the other hand, this liability of the possessor of partly-paid shares, while it often constitutes a very real risk to the investor, is a safeguard to the company's creditor. All the latter need ask himself is whether the partly-paid shares are held by a large or small body of shareholders, a fact which he can discover at Bush House. If the list is a long one, he may safely rely upon about 75 per cent of the uncalled capital as an additional asset of the company. If, however, the shares are held by only a few persons, the creditor should satisfy himself that the holders are substantial persons, and are not merely men of straw.

Classification of Shares

Besides Ordinary shares, the capital of a limited company may consist of Preference and Founders' or Deferred shares. Preference

shares possess preferential rights in respect of dividends or capital, or both. If in respect of dividend, they are entitled to receive a fixed dividend out of the profits (for instance 6 per cent Preference shares) before anything is set aside for the Ordinary shares. This dividend may be cumulative, or non-cumulative. If the former (say, 6 per cent cumulative Preference shares), the holders are entitled to have any deficiency in the dividend for any year made up out of the profits of succeeding years before any distribution is made to the Ordinary shareholders. But if the latter (6 per cent non-cumulative Preference shares), the holders, while receiving their full dividends in times of prosperity, may find these cut down in times of adversity. Sometimes the Preference shareholders, after receiving their fixed dividend, have the right to divide the surplus profits with the Ordinary shareholders, after the latter have also received a specified rate, and the shares are then described as, say, 6 per cent cumulative and participating Preference shares. If the preferential rights relate to capital, the holders, in the event of liquidation, will have prior claims over the holders of Ordinary shares to receive back their capital out of any assets remaining after the company's creditors have been satisfied in full.

Under the Companies Act of 1948, a company may issue redeemable Preference shares provided that it is empowered to do so under its articles of association, but such shares cannot be redeemed unless they are fully paid. The redemption may be effected either out of profits otherwise available for dividend or out of the proceeds of a new issue of shares. If the shares are redeemed out of profits, a sum equal to the amount required for the redemption must be transferred to a reserve fund called "The Capital Redemption Reserve Fund," which will appear on the liabilities side of the balance sheet. It should be noted that the balance sheet must show what part of the capital consists of redeemable Preference shares and also the date of their redemption.

The sections of the Companies Act which govern the issue and redemption of redeemable Preference shares are set out in Appendix III of this book.

Deferred or Founders' Shares

A matter of particular importance is the appearance of the item of Founders' shares in the capital account. This should never be overlooked. These shares, which are also known as Deferred, Deferred Ordinary, or Management shares, are generally allotted to the founders or promoters of a business in whole or part satisfaction of the purchase price. As a rule, their number, or their nominal

value, is much smaller than that of the Ordinary or Preference shares, but they usually possess privileges of a valuable nature.

Privileges of Founders' Shares

For instance, there may be 1,000 shares of 1s. each, the total nominal value being £50, with the right to receive, say, one-half the total profits remaining in any year after paying 10 per cent on the Ordinary shares. It is true that sometimes the holders of Deferred shares remain for years without a dividend, but in successful companies the amounts they draw represent enormous percentages on the nominal value of the share. Thus, the capital account of one vast and progressive company showed 1,400 Founders' shares of £1 each. After paying 8 per cent on the Ordinary shares for the year 31st January, 19.., there remained £140,663 for division among the Ordinary and Founders' shares, the proportion for the latter amounting to £68,331. Altogether, the Ordinary shareholders received the handsome dividend of 28 per cent for the year (of which 8 per cent ranked as bonus). The year's dividend on each £1 Founders' share was over £48. These 1,400 Founders' shares were subsequently taken over by a company, which bought them from the former holders at £70 each. It reads like a romance, but it is an actual fact. As a further illustration, let the reader glance at the balance sheet and accounts shown in Example 6. The Founders' shares nominal value is £2,000, and compares with £180,194 Ordinary and £200,000 Preference Capital. The profit for the year ended 19th February, 19.., amounted to £59,199, and the divisible total to £70,997. The Appropriation Account shows that this was divided as shown below.

Shares	Issued	Share of Profit Net	Amount per £1 Share	Rate % (Net after deduction of tax)
	£	£	£ s. d.	
Founders' .	2,000	8,138	4 1 4	407.00
Ordinary .	180,194	16,553	1 10	9.20
Preference .	200,000	6,300	7½	3.15
Reserve Fund . .		3,458		
Carried forward . .		8,505		
Taxation . . .		28,043		
Total . . .		£70,997		

Sufficient has been said to show the significance of Founders'

shares in the balance sheet, and a word of warning is all that need be added. Businesses are, or should be, run primarily for the benefit of the shareholders of all classes. Speaking quite generally, it is conceivable that, in certain circumstances, short-sighted directors might be tempted to starve the business for the sake of declaring large dividends on the Founders' shares, a policy which would be highly inimical to the interests of the other proprietors. Wherefore, the would-be investor or creditor should ascertain, not only that the income yield on the proposed investment is adequate compared with the privileges of the Founders' shares, but that proper and sufficient allowances are being made for maintenance and depreciation of assets and as reserves against contingencies.

Some American and Canadian companies issue shares called Shares of No Par Value. Such shares have no face or nominal value and simply represent a share in the "equity" of the company after all prior claims have been met. The holders of these shares are entitled to the surplus available and distributable among themselves in proportion to the number of shares held and not to the value. Instead of declaring a dividend in the usual manner the directors of these companies announce a distribution of so much a share.

Alteration of Capital

There is a further point which must always be borne in mind by the investigator. He should remember that although the capital account of a public company may be increased by the payment of outstanding calls on shares, or by the creation of new share capital, normally, it can never otherwise be altered. Whether the company makes profits or incurs losses, the capital account remains at the same figure in the balance sheet. This differs radically from the method adopted in the accounts of the private trader. If the latter makes a profit during his financial year, he may regard that profit as income and withdraw it, or he may leave it in the business, and it would be added to his capital account. On the other hand, if he made a loss, it would be deducted from his capital account. As a result, this account shows approximately the value of the trader's financial interest in his business, whereas in the case of the company, it affords no clue to the progress or failure of the enterprise. The reason is that the law governing limited liability companies prohibits the reduction of the issued capital except in special cases, and permission to effect a reduction can be obtained only by an expensive process in the courts. It happens, therefore, that a company may lose the bulk of its subscribed capital, and be within measurable

Example 6.—The Profits of Founders' Shares

Profit and Loss Account for the Year ending 19th February, 19..

Dr.

Corresponding figures for last year £		£
	To Expenditure—Salaries, Rent, Rates and Taxes, Carriage, Stationery, Housekeeping, Insurance, General Trade	
xxx,xxx	Expenses, etc.	695,873
x,xxx	,, Directors' Fees	4,000
xxx	,, Interest on Staff Pension Fund	210
xxx	,, Auditors' Fees	126
x,xxx	,, Depreciation	4,789
x,xxx	,, Interest on Debentures, etc.	4,638
xxx	,, Debenture Redemption Fund	835
xx,xxx	,, Net Profit for the year, carried down	59,199
£xxx,xxx		£769,670

Cr.

	£	Corresponding figures for last year £
By Total Income from Trading	769,571	xxx,xxx
,, Transfer Fees	99	xx
	£769,670	£xxx,xxx

Proposed Appropriation of Profit. 19th February, 19..

£	£		£	£
xx,xxx		To Provision for Current Taxation		8,043
		,, Reserve Fund, as provided by Memorandum of Association		3,458
x,xxx				
		,, Interim Dividends Paid—		
	x,xxx	5% on Ordinary Shares (net)	4,728	
	x,xxx	3% on Preference Shares (net)	3,150	
	x,xxx	£2 per Share on Founders' Shares (net)	2,100	
x,xxx				9,978
		,, **Proposed Final Dividends—**		
	xx,xxx	**12½% on Ordinary Shares (net)**	**11,825**	
	x,xxx	**3% on Preference Shares (net)**	**3,150**	
	x,xxx	**£5 15s. per Share on Founders' Shares (net)**	**6,038**	
xx,xxx				21,013
		,, Balance carried forward—		
	xx,xxx	On account of Ordinary Shares	8,342	
	xx	On account of Founders' Shares	163	
xx,xxx				8,505
£xx,xxx				£70,997

	£	£	£	£
By **Net Profit for year,** brought down		59,199		xx,xxx
,, Balance from last Account—				
On account of Ordinary Shares	11,699		xx,xxx	
On account of Founders' Shares	99		xx	
		11,798		xx,xxx
		£70,997		£xx,xxx

BALANCE SHEET. 19TH FEBRUARY, 19..

Corresponding figures for last year £	£		£	£
		CAPITAL AND RESERVES		
		Capital—	Authorized	Issued
xxx,xxx	xxx,xxx	Ordinary Shares of £1 each . .	200,000	180,194
xxx,xxx	xxx,xxx	6% Preference Shares of £1 each .	200,000	200,000
x,xxx	x,xxx	Founder Shares of £1 each . .	2,000	2,000
xxx,xxx	xxx,xxx		£402,000	382,194
	xxx,xxx	Revenue Reserve Fund— As per last Balance Sheet . .	165,692	
	x,xxx	Transfer from Profit and Loss A/c .	3,458	
xxx,xxx				169,150
	x,xxx	Staff Pension Fund	5,250	
	xxx	Interest for the year	210	
x,xxx				5,460
		Profit and Loss Account, balance carried forward—		
	xx,xxx	On account of Ordinary Shares .	8,342	
	xx	On account of Founders' Shares .	163	
xx,xxx				8,505
xx,xxx		Debenture Redemption Fund— Amount set aside out of Profits in accordance with Trust Deed to 19th February, 19.., and handed to Trustees for Investment *per contra* .		11,690
		SECURED LIABILITIES		
xxx,xxx		4½% Mortgage Debenture Stock . .		100,000
		CURRENT LIABILITIES		
	xx,xxx	Sundry Creditors	38,944	
	xx,xxx	Provision for current taxation . .	28,043	
	xx,xxx	Proposed final dividends (net) . .	21,013	
xx,xxx				88,000
£xxx,xxx				£764,999

	£	£	Corresponding figures for last years £	£
FIXED ASSETS				
Goodwill, at Cost		100,000		xxx,xxx
Property, including Purchase and Outlay on New Premises as per last Account (at Cost)	257,907		xxx,xxx	
Add additional outlay for year on New Buildings	40,465		xx,xxx	
		298,372		xxx,xxx
Leases, at cost		71,762		xx,xxx
Electric Plant, at cost	95,000		xx,xxx	
Less depreciation to date	16,291		xx,xxx	
		78,709		xx,xxx
Fixtures, Fittings, Furniture and Effects, at cost	5,000		x,xxx	
Less depreciation to date	1,918		x,xxx	
		3,082		x,xxx
		551,925		xxx,xxx
CURRENT ASSETS				
Stocks on hand, as certified by the Directors—General	125,721		xxx,xxx	
Stationery	817		x,xxx	
	126,538		xxx,xxx	
Sundry debtors, after allowing for bad and doubtful debts	54,642		xx,xxx	
Debenture Redemption Fund— Amount handed to the Trustees in accordance with the Trust Deed, *per contra*	11,690		xx,xxx	
Cash in hand and at Bankers . . .	20,204		x,xxx	
		213,074		xxx,xxx
		£764,999		£xxx,xxx

AUDITORS' CERTIFICATE AND REPORT
(Usual Form)

.... *Chairman* } *Directors*
.... *Managing Director* }

London, 9th March, 19..

distance of insolvency, while its capital account stands in its balance sheet at the same imposing total as that with which it started its career.

The reader may find on studying the accounts of private traders that the tendency at the present time is to have two accounts: one called Capital and the other Current or Drawings. The profits or losses made in each year are credited to the Current Account and any drawings debited to this account. As a result we have a fixed capital account which shows simply the amount invested in the business for the purpose of carrying on trade. This, of course, is only a matter of accounting and would not prevent the trader drawing on his capital account at any time. But here we must point out that the position is not the same for a limited partner in a business. This person, as the name indicates, has only a limited liability. As such he cannot reduce his capital, and with it his liability, without first having the agreement of his co-partners and his creditors. It is very necessary for a creditor making inquiries as to the safety of his debt to find out how many of the partners of the firm which owes him money are "limited" and to what extent.

Arrangement of Assets

Let us now turn to the assets side of the balance sheet. Here we find marshalled the property or possessions of the company, and also those items on which capital has been expended, but which may have no monetary value. It is customary to arrange the assets so as to show either (1) the order in which they would be used to satisfy business liabilities, or (2) their relative position of permanency in the transactions of the company. The first order is adopted chiefly by concerns whose operations are for the most part in cash, such as banks and discount houses, and by a small minority of trading companies. A fair illustration of the first order is afforded by the balance sheet which we reproduce as Example 7.

Observe the Deferred Ordinary shares in the capital account. Their nominal value is 2s. each; the dividend and bonus they received for the year were equal to 85 per cent, and this after paying 20 per cent on the Preferred Ordinary shares, 5 per cent on the Preference shares, writing off £63,661 for depreciation and adding £60,000 to the Reserve Funds.

The large majority of limited liability companies, however, set out their assets in the order of their relative permanence, beginning with land, buildings, etc., and ending with cash. There is little to choose between the two forms, but what is of importance is that the items should be so arranged as to enable the reader readily to

Example 7.—Note Arrangement of Assets

Balance Sheet. 25th December, 19..

Corresponding figures for last year £	£		£	£
		Capital and Reserves		
	xxx,xxx	350,000 5% Cumulative Preference Shares of £1 each, fully paid	350,000	
	xxx,xxx	1,800,000 20% Cumulative Preferred Ordinary Shares of 5s. each, fully paid	450,000	
xxx,xxx	xxx,xxx	**1,230,000 Deferred Ordinary Shares of 2s. each, fully paid**	123,000	923,000
	xx,xxx	Revenue Reserve Funds, as per last Balance Sheet	100,000	
xxx,xxx	xx,xxx	Transfer from Profit and Loss Account	60,000	160,000
x,xxx		Staff Provident Fund		5,397
xx,xxx		Reserve for future taxation		6,943
xx,xxx		Profit and Loss Account, balance carried forward		32,599
x,xxx,xxx				1,177,939
		Current Liabilities and Provisions		
	xxx,xxx	Sundry Creditors	141,235	
	xx,xxx	Bills Payable	4,728	
	xx,xxx	Provision for current taxation	73,624	
xxx,xxx	xx,xxx	Proposed final dividends (net)	48,692	268,279
£x,xxx,xxx				£1,446,218

Note. Schedules 1 and 2 attached to the Balance Sheet show the total cost of the different assets and the total depreciation written off to date.

	£	£	Corresponding figures for last year £	£
Current Assets				
Cash at Bankers, on Deposit and Current Account, and in hand	50,804		xx,xxx	
Money at short notice and on loan (secured by deposit of Scrip)	228,391	279,195	xxx,xxx	xxx,xxx
Investments—				
Guaranteed 2½% Stock and other Trustee Securities (at market value), as per Schedule 1	45,049		xx,xxx	
Freehold Properties (at cost, *less* depreciation), as per Schedule 1	62,633		xx,xxx	
Long Leasehold Properties (at cost, *less* depreciation) as per Schedule 1	55,743		xx,xxx	
Short Leasehold Properties (at cost, *less* depreciation) as per Schedule 1	22,645	186,070	xx,xxx	xxx,xxx
Stocks (at or below cost) as certified by Managing Directors		366,438		xxx,xxx
Sundry Debtors		15,563		xx,xxx
Accounts paid in advance		2,715		x,xxx
		849,981		xxx,xxx
Fixed Assets				
Trade Marks, at cost	122,900		xxx,xxx	
Goodwill, at cost	300,000	422,900	xxx,xxx	xxx,xxx
Furniture and Fixtures (at cost, *less* depreciation) as per Schedule 2	5,351		x,xxx	
Motor Wagons (at cost *less* depreciation) as per Schedule 2	7,879		x,xxx	
Machinery (at cost *less* depreciation) as per Schedule 2	37,902		xx,xxx	
Branch Shops and Warehouses (at cost *less* depreciation) as per Schedule 2	81,494		xx,xxx	
Works and Offices (at cost *less* depreciation) as per Schedule 2	40,711	173,337	xx,xxx	xxx,xxx
		£1,446,218		£x,xxx,xxx

distinguish the nature of the various groups which make up the total.

Classification of Assets

Leaving aside the fine distinctions which accountancy makes in several instances, for practical purposes the whole of the assets naturally fall under four heads, and it is in this order that we propose to consider them—

1. Fixed assets, that is, those which are incidental to production; such, for instance, as Land, Buildings, Plant and Machinery.

2. Circulating assets, or those produced or purchased in the course of business and held temporarily, the ultimate intention being to convert them into cash; such as Stocks-in-hand, Bills Receivable, Trade Debtors, Work-in-Progress.

3. Liquid assets, or those readily available for the discharge of liabilities; such as Cash, Bank Deposits, and realizable Securities.

4. Intangible assets, or those which have no cash value, or become practically worthless when the business is in difficulties; such as Goodwill, Patent Rights, Trade Marks, Short Leases, Debenture Discount, Preliminary Expenses, and Development Expenditure.

Proportion of Assets

While no definite percentage of the entire assets can be assigned to these groups, it is nevertheless obvious that, other things being equal, the less capital there is locked up in fixed assets compared with that in circulating and liquid assets, the healthier will be the outlook; and it may certainly be regarded as desirable that the intangible assets should be in evidence as little as possible. But every business must be considered on its merits, and in relation to its class, and hasty judgments are to be deprecated. In dissecting a balance sheet, however, it will be found advantageous to bear this principle in mind, for in investigating the position of an undertaking over a series of years, the gradual shifting of the proportion which these groups of assets bear to the whole may sometimes give the first indication of an unsound financial position.

CHAPTER III

THE "ASSETS" SIDE OF THE BALANCE SHEET

IN studying the assets of a company, the sole idea is to ascertain their worth. By virtue of the Companies Act of 1948, published balance sheets now contain fuller particulars of certain assets and liabilities of companies. The properties held by manufacturing, commercial and financial concerns are of every conceivable nature, and no one method of valuation could be applied to all; the task before us, however, is to look for such indications of value as may be shown in the balance sheet, and, when these are absent, to direct attention to the necessary points of criticism.

Fixed Assets

Let us take first the fixed assets, namely, those acquired for the purpose of carrying on the business. A large proportion of the invested capital is usually expended in the purchase of land, buildings, plant and machinery necessary for production, and it should be the constant care of the management, not only to maintain these assets at their point of highest efficiency, but to provide against the day when natural decay or obsolescence will render them useless. It is far more important to the investor that adequate sums should be spent on needful repairs, upkeep and renewals, than that he should receive a large or an increased dividend. For unless due allowance has been made for depreciation, it is sheer economic folly to pay away cash to shareholders and thus to cripple the actual means of producing any dividends at all. The temptation to gratify shareholders in this respect is often too great for weak boards of directors, who not infrequently endeavour to stave off well-merited criticisms by issuing accounts which lack details essential to the formation of an accurate judgment. The correct method is, of course, to show clearly in the balance sheet the amount allowed for depreciation, duly deducted from the value of each type of asset concerned. A bad and a good form of setting out the fixed assets are shown on page 22. The full balance sheet is unnecessary, and only the items under consideration are given.

Comparisons of Examples 8 and 9

It will be noticed that No. 8 is "silent" as to the amount of depreciation written off during the year. In such cases, the

Example 8.—Meagre Particulars

Assets		£
Property and Plant, at cost on valuation	£588,573	
Less Depreciation to date	113,849	
		474,724

Example 9.—Clearly Displayed

Assets		£	£
Freehold Land and Buildings, as valued at 31st December, 19.., as per last account		366,594	
Additions during the year		1,619	
		368,213	
Less Land sold		16,468	
		351,745	
Less Depreciation written off in previous years	£13,636		
„ Depreciation written off this year . .	2,482		
		16,118	
			335,627
Plant, Machinery, Models, etc., at cost, as per last account .		231,357	
Additions during the year		5,471	
		236,828	
Less Depreciation written off in previous years	£81,982		
„ Depreciation written off this year . . .	15,749		
		97,731	
			139,097
			£474,724

investigator must seek his information in the profit and loss account. In the present case, the profit and loss account supplies the following particulars—

"Depreciation, £21,347."

No. 9 has decided claims to commendation. It shows the total value of the assets at the beginning of the financial year and the new expenditure of the year. From the total is deducted the previous depreciation written off, also the amount allowed for the year just closed. A simple calculation then gives the percentage which the depreciation bears to the book value. As balance sheets go it is admirably clear.

Reserve for Depreciation

Occasionally there appears the item "Reserve for Depreciation" of buildings, plant, machinery, and so on. It is important that the

investigator should learn to recognize this item under its several aliases. Sometimes it occurs as a "Depreciation Account," sometimes as a "Depreciation Fund." The word "Fund" suggests to the ordinary mind the existence of a cash reserve or an equivalent, but the student of balance sheets will find it necessary to correct this impression. Example 10 illustrates this point. It will be noticed that certain assets, totalling £132,565, are taken into account "at cost." During the eleven years of the company's existence, while the Elevators and Machinery generally have been maintained in a state of high efficiency (*vide* Directors' Report) nothing has been written off the individual items. Instead, annual sums have been transferred (on paper) from profit to a "Depreciation Fund" which at the date of the balance sheet amounted to £50,008, so that the actual book value of the group of assets referred to is £132,565 − £50,008 = £82,557. But there is no *fund*—as this word is generally understood—representing this £50,008; it is "in the business," i.e. it is part of the total of £185,931 of tangible and intangible "assets" shown in the balance sheet. Another source of information on this subject which should not be overlooked is the Auditors' Report, which must be actually attached to a company's balance sheet. Auditors, who value their reputation, frequently have occasion to comment on the fact that insufficient depreciation has, in their opinion, been allowed. As it is probable that such statements seldom appear unless there has previously been a battle with the board, the warning should never be neglected. Finally, it should be remembered that directors are not necessarily expert valuers of estates and buildings, and complicated plant and gear. The best safeguard, therefore, which shareholders have is a periodical, independent valuation of the property by an efficient assessor (see Example 11 (A)), so that the figures standing in the company's books may be adjusted to the expert's estimate. The expense of such a matter would be trifling compared with the satisfaction of knowing with some certainty the position of affairs, while it would also afford a valuable index as to the approximate amount of depreciation which should be written off annually. Life assurance companies are compelled by law to have such a revaluation every five years, and the idea is worthy of extensive application to commercial corporations.

Circulating Assets

The circulating assets we have defined generally as those produced or purchased in the course of business and held temporarily, the object being to convert them into cash; for instance, stock, bills

Example 10.—A

BALANCE SHEET.

Corresponding figures for last year £	£		£	£
		SHARE CAPITAL		
		Authorized		
	xxx,xxx	25,000 Ordinary Shares of £5 each	125,000	
	xx,xxx	75,000 6% Cumulative Preference Shares of £1 each	75,000	
	£xxx,xxx	100,000	£200,000	
		Issued		
	xxx,xxx	22,496 Ordinary Shares of £5 each	112,480	
	xx,xxx	52,492 6% Cumulative Preference Shares of £1 each	52,492	
xxx,xxx		74,988		164,972
x,xxx		Profit and Loss Account, balance carried forward		738
xxx,xxx				165,710
		CURRENT LIABILITIES		
	xx,xxx	Amount advanced by London and India Docks Company, under Agreement, for lease of land to this Company, and for construction of Grain Transit Silos	20,000	
	x,xxx	*Deduct* Repayments	7,360	
	xx,xxx		12,640	
	x,xxx	Sundry Creditors	3,862	
	x,xxx	Provision for Current Taxation	1,712	
	xxx	Proposed final Preference Dividend (net)	826	
	x,xxx	Proposed Ordinary Dividend (net)	1,181	
xx,xxx				20,221
£xxx,xxx				£185,931

Contingent Liability—
On Contracts for Work not yet executed (estimated) £1,050

receivable, trade debts, etc. It is, perhaps, scarcely necessary to point out that each item must be judged strictly in relation to the balance sheet in which it appears. Thus, the stock of an engineering company might consist, in part, of machinery manufactured for sale (circulating asset), but in the balance sheet of a purchaser who used it for production the same machinery would appear as part of the plant (fixed asset).

In examining the item of "stock" the following points are useful. It should always be obvious from the balance sheet that there has been an actual stock taking, and that the amount does not represent merely the balance of the stock book.

For instance—

Stock on hand £10,000

divulges but little, but—

Stocks on hand, as per inventories, at cost . £10,000

makes it clear there has been a checking of the goods, and also what the basis of valuation is. (See Example 11 (B).) On no account should enhanced value, due to a higher current market price, be

Depreciation "Fund"

31ST DECEMBER, 19..

	£	£	Corresponding figures for last year £	£
FIXED ASSETS				
Goodwill, at cost		75,953		xx,xxx
Plant and Machinery, at cost	46,214		xx,xxx	
Barge Account, at cost	36,188		xx,xxx	
Transit Silo Account, at cost	44,558		xx,xxx	
Tug Account, at cost	5,605		x,xxx	
	132,565		xxx,xxx	
Less Depreciation Fund	50,008		xx,xxx	
		82,557		xx,xxx
Office Furniture and other Effects, at cost		504		xxx
		159,014		xxx,xxx
CURRENT ASSETS				
Gear and Stores	5,257		x,xxx	
Coals on hand	604		x,xxx	
"New York" Hire-purchase Account	4,789		x,xxx	
Sundry Debtors	5,217		xx,xxx	
Payments in Advance	2,300		x,xxx	
Cash at Bankers	4,446		xxx	
Cash on Deposit Account	4,300		—	
Cash in Hand	4		xx	
		26,917		xx,xxx
		£185,931		£xxx,xxx

taken into the balance sheet, nor need a temporary fall in value be considered, but any depreciation arising from loss, damage, age, or change of fashion should invariably be written off.

Another point which the reader should ascertain, if possible, is—

What is the relation of the Stock figure to the total Sales figure for the year? With the exception of some manufacturing concerns, it is safe to say that there should be normally a steady ratio between the two figures.

In "Sundry Debtors," the balance sheet should distinguish between trade debts and other amounts owing to the firm. Sometimes directors and officials borrow money from the company, and these advances must be set out separately and not included with debts due from customers. If money has been advanced, it should be made clear whether adequate security has been obtained. (Act of 1948, Sections 190 and 197.)

A careful estimate of the outstanding accounts should, of course, be made, and the amount estimated to be doubtful of collection should be provided for by a reserve, and the same shown in the balance sheet as deducted from the total book debts.

Example 11.—Some

BALANCE SHEET.

Corresponding figures for last year £	£		£	£
		CAPITAL RESERVES AND UNDISTRIBUTED PROFITS		
		Authorized Capital—		
	xx,xxx	30,000 Ordinary Shares of £1 each	30,000	
	xx,xxx	55,000 6% Preference Shares of £1 each	55,000	
	£xx,xxx		£85,000	
		Of which have been issued—		
	xx,xxx	30,000 Ordinary Shares of £1 each, fully paid	30,000	
	xx,xxx	50,000 6% Preference Shares of £1 each, fully paid	50,000	
xx,xxx				80,000
x,xxx		**Revenue Reserve Fund (invested—see Contra)**		**2,000**
xxx		Reserve on Buildings Account		189
x,xxx		Reserve for future taxation		2,000
x,xxx		Profit and Loss Account balance carried forward		2,306
xx,xxx				86,495
		SECURED LIABILITIES		
	xx,xxx	Mortgage Debentures, 700 at £50 each	35,000	
	xxx	Interest thereon to date (gross)	437	
xx,xxx				35,437
		CURRENT LIABILITIES		
	x,xxx	Creditors	8,774	
	xx	Unclaimed Interest and Preference Dividends	27	
	x,xxx	Provision for current taxation	3,542	
	xxx	Proposed final Preference Dividend (net)	394	
	x,xxx	Proposed final Ordinary Dividend (net)	1,575	
xx,xxx				14,312
£xxx,xxx				£136,244

Admirable Features

31ST DECEMBER, 19..

				Corresponding figures for last year	
		£	£	£	£
FIXED ASSETS					
Leasehold Premises at the Purchase Price		40,000		xx,xxx	
Less Depreciation written off annually— No. 1 (987 years unexpired); No. 2 (975 years unexpired); No. 3 (38 years unexpired)		6,015		x,xxx	
			33,985		xx,xxx
Fixed Plant, Machinery, and Fixtures, Loose Plant, Tools, and Utensils in and about works, *less* Depreciation written off, viz.—					
(A) As re-valued by Valuer and Sons		23,586		xx,xxx	
Additions since		7,473		x,xxx	
		31,059		xx,xxx	
Less **Reserve for Depreciation**		6,253		x,xxx	
			24,806		xx,xxx
Goodwill, Trade-marks, and Patent Rights at the Purchase Price .			34,800		xx,xxx
CIRCULATING ASSETS					
(B) Stock-in-trade as Certified by the Company's Officials .			18,967		xx,xxx
Debtors			16,138		xx,xxx
LIQUID ASSETS					
Cash at Bank and in hand			3,707		x,xxx
Investments at cost, viz.—					
On account of Reserve Fund		2,000		x,xxx	
Other Investments		1,390		x,xxx	
			3,390		x,xxx
viz.—	£				
£500 Tees Conservancy 3% Redeemable Stock at cost	500				
£100 Wigan Corporation 3% Redeemable Stock at cost	100				
£180 Richmond Corporation 3% Redeemable Stock at cost	172				
£333 1s. 11d. Tunbridge Wells Corporation 3% Redeemable Stock at cost	328				
£500 Hull Corporation 3% Stock at cost . .	484				
£184 11s. 10d. Natal 3% Consolidated Stock at cost	176				
£1,000 Torquay Corporation 3% Stock at cost	920				
	2,680				
[NOTE. The value of the above investments at the middle market prices at the date of the Balance Sheet was £2,350 8s. 7d.]					(x,xxx)
Freehold Property, No. 1 and Leasehold Property (991 years unexpired) at cost . .	710				
	£3,390				
Unexpired proportions of Insurances, etc.			451		xxx
			£136,244		£xxx,xxx

Example 12.—Company Invests

BALANCE SHEET.

Corresponding figures for last year £	£		£	£
		CAPITAL AUTHORIZED AND ISSUED		
	xx,xxx	60,000 Ordinary Shares of £1 each, fully paid	60,000	
	xx,xxx	60,000 5½% Cumulative Preference Shares of £1 each, fully paid	60,000	
xxx,xxx				120,000
		REVENUE RESERVES AND UNDISTRIBUTED PROFITS		
	xx,xxx	General Reserve	34,000	
	x,xxx	Transfer from Profit and Loss Account	3,000	
	xx,xxx		37,000	
	x,xxx	Profit and Loss Account	2,307	
xx,xxx				39,307
		DEBENTURES		
	xx,xxx	600 4½% First Mortgage Debentures of £50 (of which 100 are held by nominees for the Company)	30,000	
	xxx	Interest accrued thereon to date (gross)	675	
xx,xxx				30,675
		CURRENT LIABILITIES		
	x,xxx	Sundry Creditors	7,540	
	x,xxx	Provision for current taxation	5,216	
	xxx	Proposed final Preference Dividend (net)	866	
	xxx	Proposed final Ordinary Dividend (net)	945	
xx,xxx				14,567
£xxx,xxx				£204,549

As a rule, the item of "Bills Receivable" has no supplementary information in the balance sheet, but should the amount be unusually large, or should there be other factors in the general position which cause disquiet, the standing of the drawers of the bills, and the dates on which the bills fall due, should certainly be inquired into.

Liquid Assets

The third group consists of "liquid assets," those readily available for discharging liabilities or meeting contingencies, such as cash, bank deposits, and investments of an easily realizable nature. The first two items are self-explanatory, but the third is often deceptive to a high degree.

Investments

In the large majority of balance sheets, very few details are vouchsafed as to the investments. Broadly speaking, there are three reasons, any of which may induce a company to purchase securities. It may desire to invest surplus capital pending the use of the money in the business; it may take an investment interest in a company of an allied trade; or it may invest the reserved profit ("Reserve Fund") which has been set aside for meeting emergencies. The facts should be clearly stated, and not left to the intuition of the investigator, for in but few cases can secrecy be justified.

in its Own Debentures

31ST DECEMBER, 19..

			Corresponding figures for last year	
FIXED ASSETS	£	£	£	£
Freehold Land and Buildings, *as per last Balance Sheet*, at cost	39,877		xx,xxx	
Additions, at cost	1,561		x,xxx	
		41,438		xx,xxx
Fixed and Movable Plant, Machinery, Dies, Tools, Patterns, etc., at cost	21,497		xx,xxx	
Less Depreciation	1,074		x,xxx	
	20,423		xx,xxx	
Additions for the year, at cost	154		—	
		20,577		xx,xxx
Office Furniture, at cost		50		xx
Goodwill of Business, *as purchased*		81,868		xx,xxx
		143,933		xxx,xxx
CURRENT ASSETS				
Investments in the Company's own Debentures, at cost		5,030		x,xxx
Stock-in-Trade, *at valuation*		19,610		xx,xxx
Book Debts, after providing for Discounts, Doubtful Debts, etc.		21,192		xx,xxx
Bills Receivable		54		—
Cash in hand and at Bankers		14,730		xx,xxx
		£204,549		£xxx,xxx

The Companies Act, 1948, requires trade investments to be shown quite separately from both unquoted investments and quoted investments. In the case of quoted investments, they must be further divided between those for which permission has been given to deal on a recognized Stock Exchange, and those not granted permission. Furthermore the market value of quoted investments must be shown. In addition, a list of the actual investments might well be given. An example of frankness is afforded by the balance sheet reproduced as Example 11.

Many of the great investment corporations, with invested funds running into millions sterling, publish full lists of their holdings and of the nominal amounts held, and there is seldom any reason why trading and industrial companies should be less generous of detail. Sometimes a company will take advantage of the possession of surplus cash to buy some of its own debentures in the market, and these often appear among the investments. By so doing the company saves the interest payable on the bonds, but it is preferable to regard the expenditure as a reduction of the company's outstanding obligations rather than as an investment, and the sum thus employed should be subtracted from the total amount of the debentures issued, which appears on the liabilities side of the balance sheet. In Example 12 the company hold £5,000 of their own debentures on which they pay themselves interest in the ordinary course.

Intangible Assets

An important group of items on the assets side is that of the "Intangible Assets." The investigator should learn readily to distinguish these, for he will need to eliminate most of them when he is computing the actual value of the company's position as a business concern. The legal view is curiously at variance with the commercial view in this matter. For instance, a private business man, who had mortgaged certain of his properties to obtain additional working capital, would not place the expenses incidental to that transaction in his balance sheet as an asset; but that is precisely what a company in similar circumstances does. Let us say it requires money, and raises it on debentures. To tempt investors, it will perhaps issue at a discount (say 90 per cent) and as they must be paid back at 100 per cent, there is, to begin with, a direct loss of 10 per cent on the new loan capital. Then the cost of printing and advertising the prospectus, the underwriting, legal costs and stamp duties, form together another considerable item, amounting to, say, 5 per cent; and in the end the total loss and cost are included in the balance sheet among the "Assets" (see Example 1, page 2), where, legally, they may remain as long as the company lasts. Or again, the initial expenses of forming, registering and floating the company are often shown as assets under the heading of "Preliminary Expenses." As a matter of fact, these items, so far from being "Assets," represent irrecoverable outlay, and a healthy company would set aside a portion of its profits each year until it had cleared them out of the balance sheet.

Goodwill

The most common feature of this group is "Goodwill." Assuming this to be the "benefit arising from connection and reputation," it would certainly have a saleable value if the business were being sold as a going concern. But the critic should never pass carelessly over this item. He should consider its size in relation to the profits, bearing two main rules of judgment in mind, namely, that the smaller the capital required to produce a given income, the larger in proportion may be the goodwill; and the more skilled the supervision which the business requires, the smaller in proportion should be the goodwill. In the commercial world a trading firm doing a steady business with old-established connections would perhaps command the largest goodwill. As a rough guide, it may be said that the goodwill of a private trading business ranges from 1 to 5 years' purchase (based on the average annual profits); of a manufacturing concern from 1 to 4 years; of a professional

connection 1 to 3 years; but that of newspapers and other semi-monopolies will range up to 10 years' purchase.

When a joint-stock company buys a business it generally pays more for the goodwill than would a private trader in the same circumstances, because the latter risks more should the business fail than do the shareholders. But after making ample allowance for this fact, it will frequently be found that the amount of goodwill shown in the balance sheet is excessive.

Goodwill should not be shown in the balance sheet at a figure more than its cost price; in other words, it should not be written up because the business proves successful. The fact that a company is in a position to reduce or write off its goodwill is in itself a good proof that the goodwill is alive and of value. The writing off of such an asset is one method of retaining profits in the business and thus a cheap way of conserving its working capital.

In buying a going concern, a company pays for the assets, including goodwill, with its capital, and the more the goodwill costs, the larger is the number of shares it must issue.

Over-capitalization

When the price paid for a business is so high that the company cannot earn dividends on its shares equivalent, say, to 2 or 3 per cent over bank rate, the company may be said to be "over-capitalized," and sooner or later there will be grave trouble. For with the first spell of declining trade, the value of goodwill as a disposable asset tends rapidly to diminish, and hence many well-managed companies gradually write off this item year by year until it is either extinguished or reduced to a fair minimum, although there is not the slightest legal compulsion upon them to do so.

CHAPTER IV

THE "LIABILITIES" SIDE OF THE BALANCE SHEET

JUST as there are "Assets" which are valueless, so there are "Liabilities" which have not to be paid. As a rule, there is little difficulty in discovering from the balance sheet the amount of an undertaking's debts; it is the items remaining after these have been ascertained that sometimes occasion bewilderment. The liabilities can conveniently be grouped under two heads: (1) Those which are debts owing to the public, such as debentures and overdue interest thereon; amounts lent to or deposited with the company; trade creditors; bills payable, etc.; and (2) those which the business is deemed to owe to the shareholders, among which are the share capital, reserve funds, and a credit balance of the profit and loss account.

The order in which these groups are placed is that of their respective importance, for the real debts of a business are those which can be enforced against it by its creditors, whilst the term "Liabilities to the shareholders" is merely a *façon de parler*. Let us make this latter point clear. If the reader will refer to the balance sheet, Example 13, he will observe that the liabilities have been set out under the two headings mentioned, and that the total of £560,527 is made up of £388,676 due "to the shareholders," and £171,851 due "to the public."

If we were to assume, for the purpose of illustration, that it was desired to wind up this company, and its assets were turned into cash at the values shown in the balance sheet (£560,527), then, after the debt owing "to the public" had first been paid, the balance of £388,676 would be available for the shareholders, who would thus receive over 30s. for every £1 of capital they held in the company. But supposing the assets realized more than £560,527, then the balance for division after paying out the creditors would be greater; whilst, if they sold for less, the amount the shareholders would receive would be correspondingly reduced.

Thus the shareholders are entitled to nothing except what is left after the claims of other parties have been settled, and the nominal amount at which the said "Liabilities to the shareholders" stand in the balance sheet does not make the slightest difference to the result.

Example 13.—Classification of Liabilities

BALANCE SHEET, AS AT 31ST DECEMBER, 19..

Corresponding figures for last year £	£		£	£
		Liabilities to the Shareholders—		
		Capital, Authorized and Issued, 20,000		
	xxx,xxx	Ordinary Shares of £10 each	200,000	
		5,000 Cumulative Preference Shares of		
	xx,xxx	£10 each	50,000	
xxx,xxx				250,000
xxx,xxx		Revenue Reserve Fund		105,000
		Profit and Loss Account, balance carried		
xx,xxx		forward		20,426
xx,xxx		Proposed dividends (net)		13,250
xxx,xxx				388,676
		Liabilities to the Public—		
	xx,xxx	Loans on Debentures	53,142	
	xx,xxx	Current taxation	13,135	
	xx,xxx	Deposit Accounts	25,967	
	x,xxx	Sundry Creditors	9,607	
	xx,xxx	Bills Payable	70,000	
xxx,xxx				171,851
£xxx,xxx				£560,527

	£	£	Corresponding figures for last year £	£
FIXED ASSETS				
Land and Buildings (at cost)	254,967		xxx,xxx	
Less—Amount of Depreciation to date	67,461		xx,xxx	
		187,506		xxx,xxx
Machinery (at cost)	164,207		xxx,xxx	
Less—Amount of Depreciation to date	51,855		xx,xxx	
		112,352		xxx,xxx
Steam Launch and Boats (at cost)	12,728		xx,xxx	
Less—Amount of Depreciation to date	8,228		x,xxx	
		4,500		x,xxx
Estate No. 1 (at cost)	1,331		x,xxx	
Estate No. 2 (at cost)	132		xxx	
		1,463		x,xxx
		305,821		xxx,xxx
CURRENT ASSETS				
Stocks in Hand and Afloat	196,275		xxx,xxx	
Sundry Debtors	45,002		xx,xxx	
Exchange Suspense	686		xxx	
Bank Balances	10,873		xx,xxx	
Cash Balances	1,870		x,xxx	
		254,706		xxx,xxx
		£560,527		£xxx,xxx

Debentures

First let us take the "Liabilities to the public." As a rule, the largest item under this head is "Debentures." The debenture-holder is a lender to the company, and holds its acknowledgment and promise of repayment made over the seal of the company. He takes no share of the profits, but he must be paid a specified interest on certain dates whether there are profits or not. If the interest is not paid within a stated period after it falls due, the debenture-holder has the right to step in and reimburse himself for the full amount of his debt and the interest owing. The chief concern of the would-be purchaser of debentures, therefore, is to see that there are sufficient assets not only to cover the total amount of the issue of which his debentures form part, but to leave a substantial margin of security, and, further, that the debentures are secured upon specific property.

There should be a trust deed, and a trustee duly appointed, in order that the latter may take instant action on behalf of all debenture-holders, if occasion arises. This information will not be found in the balance sheet, but it can generally be obtained from *The Stock Exchange Official Year Book*, or from the Registrar of Companies, Bush House, Aldwych, W.C.2.

How Debentures Should be Stated

Under the Companies Act, 1948, the balance sheet must explicitly state the amount of debentures or debenture stock outstanding, the rate of interest thereon, whether the debentures are redeemable within a given time, and particulars of any redeemed debentures that may be reissued. Also it must state whether any of the debentures have been bought by the company itself and are held by a nominee or trustee of the company; also whether any are held by its holding company or by a fellow subsidiary.

In addition, the price at which the debentures were issued should be ascertainable, and the investigator should scan the "Assets," among which the discount on the debenture issue is sometimes placed. (See Example 1.) This latter point is one of exceptional interest to the ordinary trade creditor, whose position differs from that of the debenture-holder in that he has none of the company's property specially set aside for the satisfaction of his claim in case of trouble overtaking the concern.

Debentures as Index of Stability

The discount at which a company is compelled to offer its debentures, and the rate of interest it must pay in order to attract

persons willing to advance the money, are gauges of the company's stability, because a valuation of the assets invariably precedes the debenture issue; therefore, the heavier the discount, and the higher the interest rate, the more risky as a rule is the investment. In computing his position, then, on a rock-bottom basis, the ordinary creditor must rule out from the assets those properties which are mortgaged to the debenture-holders, or at least deduct therefrom the full amount of the debentures, and a wide margin to cover loss on realization.

Sundry Creditors

The term "Sundry creditors" is one of those vague phrases often used to cover a number of items very different in nature. Everyone to whom money is owed is a creditor, but it makes all the difference whether the money is owing to trading firms for goods supplied in the ordinary course of business, or is repayable to bankers on account of advances. "Sundry creditors" is better employed to denote miscellaneous items, such as proportion of rent, rates, and taxes accrued but not due, and small accounts; whilst the other outstanding amounts should be shown under proper headings, such as trade creditors, bills payable, bank loans, deposits, accrued interest on debentures, etc.

Where these distinctions are not shown, inquiry should be made as to the facts behind the figures which are given. A brief comment on these items is all that need here be made.

Trade creditors, and bills payable, will represent materials and goods purchased, the *unsold* part of which is represented by the stock and work-in-progress; and the *sold* portion by trade debtors, bills receivable, and cash. If this group of liabilities exceeds the assets mentioned, the trading is likely to have been unsatisfactory, and there will be pressure on the part of the creditors.

Bankers' Loans on Security

Where a loan from bankers appears, the reason for the loan should be sought. It may be that further capital expenditure in the shape of new premises and plant has been required by an expanding business, and that advantage has been taken of cheap money to borrow from the bankers at a low rate rather than go to the expense of issuing debentures. But bankers do not advance money without security, and this frequently takes the form of a pledge on the company's investments or a lien on its property, enforceable even

in front of the debenture-holders' mortgage. An instructive illustration is afforded by Example 14. Observe that in addition to the debenture issues which we have marked A, B, C, the company had also outstanding at the date of the balance sheet large amounts of debenture stock as security for advances made to it. Included in the £733,276 was a bank overdraft and also some temporary loans, and the debenture bond issued in respect thereof was as follows—

£100,000	4½%	Mortgage Debenture Stock
95,000	5%	" " "
500,000	5%	" " "
£695,000		

The last item is specifically mentioned as having been issued against the bank overdraft, but, as security, it ranks after the other issues. Note that this £695,000, as a liability, comes in front of the ordinary trade creditors.

In the balance sheet reproduced (Example 15) the reader will

Example 14.—Bank Loans

BALANCE SHEET.

Corresponding figures for last year £	£		£	£
		Share Capital: *Authorized*—		
	x,xxx,xxx	250,000 Ordinary Shares of £5 each	1,250,000	
	x,xxx,xxx	250,000 5% Cumulative Preference Shares of £5 each	1,250,000	
	£x,xxx,xxx		£2,500,000	
		Issued—		
	x,xxx,xxx	229,534 Ordinary Shares of £5 each, fully paid	1,147,670	
	x,xxx,xxx	245,045 5% Cumulative Preference Shares of £5 each, fully paid	1,225,225	
x,xxx,xxx				2,372,895
		SECURED LIABILITIES		
	xxx,xxx	(A) 4% First Mortgage Debentures (authorized and issued)	500,000	
	xxx,xxx	(B) 4½ per cent Mortgage Debenture Stock (authorized issue, £500,000); *issued* **£100,000 also issued as Security for temporary Loans**	400,000	
	xxx,xxx	(C) 5% Mortgage Debenture Stock (authorized issue, £1,000,000); *issued* **£95,000 also issued as Security for temporary Loans**	800,500	
	xx,xxx	Interest accrued on above (gross)	28,012	
	(xxx,xxx)	**5% Mortgage Debenture Stock, ranking after the above Debentures and Debenture Stocks as Security for Bank Overdraft £500,000**		
x,xxx,xxx				1,728,512
		CURRENT LIABILITIES		
	xx,xxx	Sundry Creditors	36,740	
	xxx,xxx	Bank Overdraft	550,560	
	xxx,xxx	Temporary Loans	145,976	
xxx,xxx				733,276
		NOTE. *Dividends on the 5% Cumulative Preference Shares are in arrear since June, 19..*		
£x,xxx,xxx				£4,834,683

find a very clear example of this. The loan amounts to £94,000, and a note adds the information that this is secured by the deposit of 4 per cent Consols, Mersey Docks and Harbour 2½ per cent, and the deeds of certain freehold properties. It is true the properties are not named, but on the opposite side of the balance sheet the amounts of the two stocks referred to are given, as well as the price at which they are taken into the accounts. Where, however, it is not a case of business expansion, and the loan is for ordinary commercial purposes, it is not, as a rule, a good sign, and it will probably be found that the book debts are difficult of collection, or that longer credits are being allowed by the firm to its customers than its creditors allow to it. If the reason be different—such as, for instance, that the money was advanced to enable the management to take advantage of an exceptional buying opportunity—this fact will generally be found stated in the directors' report, or it will be imparted in the chairman's address at the annual meeting of the company.

and their Security

31ST DECEMBER, 19..

	£	£	Corresponding figures for last year £	£
FIXED ASSETS				
Freehold and Leasehold Land (at cost)	656,973		xxx,xxx	
Less Depreciation to date	165,089	491,884	xxx,xxx	xxx,xxx
Buildings (at cost)	978,462		xxx,xxx	
Less Depreciation to date	108,477	869,985	xxx,xxx	xxx,xxx
Machinery (at cost)	252,619		xxx,xxx	
Less Depreciation to date	48,671	203,948	xx,xxx	xxx,xxx
		1,565,817		x,xxx,xxx
Investments—				
Shares in Subsidiary Companies (at cost)	1,201,591		x,xxx,xxx	
Trade Investments (at cost)	810,052	2,011,643	xxx,xxx	x,xxx,xxx
CURRENT ASSETS				
Stock in Trade, as valued by officials of the Company	249,924		xxx,xxx	
Work in Progress (less instalments received)	327,634		xxx,xxx	
Trade Debtors	413,102		xxx,xxx	
Debts due from Subsidiaries	61,402		x,xxx	
Bills on Hand	6,970		xx,xxx	
Cash at Bankers and in Hand	77,585	1,136,617	x,xxx	x,xxx,xxx
PROFIT AND LOSS ACCOUNT				
Trading Profit for the year, after depreciation, etc.	128,740		xx,xxx	
Less Debenture Interest	78,025		xx,xxx	
	50,715		xxx	
Less Brought forward from last year	171,321	120,606	xxx,xxx	xxx,xxx
		£4,834,683		£x,xxx,xxx

Acceptance of Deposits

A comparatively new feature among companies which do a large retail business is the growing practice of accepting deposits. This is merely borrowing working capital from customers instead of from outsiders, and there is this risk attached, that a temporary set-back to the company's prosperity might cause a rush on the part of the depositors to withdraw their money, with the result that the business would be depleted of cash, and forced either to borrow elsewhere at heavy rates of interest, or to sell its available assets at a sacrifice to meet current liabilities. The student of balance sheets should be careful to ascertain whether the business is trading on a substantial financial margin, or if it is dependent upon its depositors' money for its cash working capital.

Liability to Shareholders

Of the "Liabilities to the shareholders," the principal will be the amounts which have been subscribed for shares, and this item has already been dealt with under the heading of Capital Account. With regard to the question of any new issue of share capital, it may be well to remind the reader that the applicant, who desires to withdraw his application for shares in a company, can only demand the return of his money provided he cancels his application before the allotment letter has been posted to him by the company. After the precise moment of posting, neither letter nor telegram nor personal call will entitle him to a refund, and, except he can arrange a transfer in the usual way, he must pay all amounts properly called up on the shares. The application form and allotment letter taken together constitute a binding contract in law. The contract can only be broken or avoided on the grounds of irregularity or by the death of the applicant prior to the receipt of the allotment letter.

Reserves

A prudent board of directors will always recommend that a portion of the profits of the year be placed aside to meet contingencies before paying a dividend. The amounts thus put aside form a "Reserve." Under the Companies Act, 1948, these Revenue Reserves must be shown separately on the balance sheet.

Distinction Between Reserve and Depreciation

Let the reader at this point clearly distinguish between a "Reserve" and what has already been referred to as "Depreciation." Depreciation should be written off before arriving at the year's

Example 15.—Assets Pawned for Bank Loans

Balance Sheet at 31st December, 19..

Corresponding figures for last year £	£		£	£
		Capital and Reserves		
		Share Capital, Authorized and Issued—		
	xxx,xxx	7,000 Deferred Ordinary Shares, £100 each	700,000	
	xxx,xxx	50,000 Preferred Ordinary Shares, £10 each	500,000	
	x,xxx,xxx	180,000 Preference Shares, £10 each	1,800,000	
x,xxx,xxx				3,000,000
	xxx,xxx	Revenue Reserves	110,577	
	xx,xxx	Reserves for future U.K. taxation	20,000	
	xx,xxx	Profit and Loss Account, balance carried forward	17,037	
xxx,xxx				147,614
	xx,xxx	Sinking Fund for Redemption of Leaseholds and Goodwill	34,686	
	x,xxx	Transfer from Profit and Loss Account	4,493	
xx,xxx				39,179
		Secured Liabilities		
	xxx,xxx	First Mortgage 4% Debenture Stock (Secured by the vesting in Trustees of certain Freehold and Leasehold Properties, and by a Floating Charge.)	687,475	
	xxx,xxx	"B" 4% Debenture Stock (Secured by a second Floating Charge)	473,190	
	x,xxx	Debenture Interest accrued (net)	6,093	
	xx,xxx	**Loan from Bankers (Secured by the deposit of Consols, Mersey Docks and Harbour Stock and Deeds of certain Freehold Properties)**	94,000	
x,xxx,xxx				1,260,758
		Current Liabilities		
	xx,xxx	Trade Creditors	74,689	
	xxx,xxx	Deposit Accounts	106,063	
	xx,xxx	Provision for current U.K. taxation	26,596	
	xx,xxx	Proposed final Dividends (net)	28,744	
xxx,xxx				236,092
£x,xxx,xxx				£4,683,643

Contingent Liability on Guarantee of Customer's Mortgage £20,000

	£	£	Corresponding figures for last year £	£
Fixed Assets				
Goodwill (at cost)		291,755		xxx,xxx
Premises (at cost)	231,269		xxx,xxx	
Less Depreciation to date	101,076		xxx,xxx	
		130,193		xxx,xxx
Freeholds (at cost)		1,296,404		x,xxx,xxx
Leaseholds and Reversionary Leaseholds, which are being provided for by sinking funds (at cost)		856,566		xxx,xxx
Plant and Machinery (at cost)	211,694		xxx,xxx	
Less Depreciation to date	41,673		xx,xxx	
		170,021		xxx,xxx
Motor Vehicles (at cost)	3,000		x,xxx	
Less Depreciation to date	700		xxx	
		2,300		x,xxx
Trade Investments (at cost)		205,734		xxx,xxx
Current Assets				
Quoted Investments—				
4% Consols £25,132 14s. at 84	21,111		xx,xxx	
Mersey Docks and Harbour 2½% £85,150 at 40. (Market Value £54,165)	34,060		xx,xxx	
		55,171		xx,xxx
Loans to Publicans		1,548,743		x,xxx,xxx
Sundry Debtors and payments in advance		44,049		xx,xxx
Stock of Beer, Materials, Casks, etc., as valued by the Directors		70,157		xx,xxx
Cash in hand and at Bank		12,550		x,xxx
		£4,683,643		£x,xxx,xxx

profits; the reserve is built up by setting aside portions of the profit itself. Depreciation represents the estimated wear and tear which will ultimately reduce the property and plant to scrap value; reserve represents the amounts set aside to provide the business with additional working capital. For example: a man buys a motor-car for £500. He estimates that it will serve his purpose for five years, and that he could then sell it for £50. He therefore writes off out of his *gross receipts* the difference of £450—his estimated loss—by five annual sums of £90. At the end of that time he has £50, but no motor-car, and he should have £450 accumulated in the liquid assets of the business, as a result of having put through charges for depreciation to the accounts each year. However, if he estimates that it will cost him £900 to replace the car at current prices, then the £450 accumulated depreciation plus the £50 received for the old car will not provide enough to buy a new car. In order to accumulate in the business the additional £400 needed, he should set aside, out of his actual *net income*, reserves of £80 a year. Then, when he comes to replace the car at current prices, he will have retained in the business the extra funds needed. However, the difference between these two items should be clearly understood. The first one, the depreciation, is a charge against the gross earnings of the business. The profit cannot be stated until this charge has been made in the accounts for the assets that have been worn out in the process of running the business. The second item, the reserve to provide the additional money needed to replace the assets at inflated prices, is an appropriation out of the profits earned. Therefore, if ever an item in a balance sheet is described as a Depreciation Reserve, or Depreciation Fund, or any such name (See Example 10, page 25) it must be carefully scrutinized to see if it is just the accumulated depreciation to be deducted from the corresponding assets, or if it is an amount of profit set aside to provide for the inflated replacement price of those assets.

General and Specific Reserves

Reserves may be formed either for specific purposes, such as providing for the additional inflated price at which it may be necessary to renew buildings, plant and machinery, rolling-stock, etc., or for meeting unavoidable and unforeseen reverses of fortune, or for providing additional production facilities or working capital as the business expands, or as inflation makes it necessary, and the balance sheet ought to be quite explicit on that point. But in no case should the size of the reserve as given in the balance sheet be taken as necessarily corresponding to an actual amount of cash in

the possession of the company, or as available for instant use, unless the figures actually show this. In some few cases, such as banks, insurance, and financial companies, where all the assets, practically, are "liquid," the reserve will indeed be an available one, but, as a rule, it will be found to be not separately invested but "employed in the business."

Realizability of Reserves

The extent to which the reserves are realizable depends, therefore, on the nature of the assets, and these are frequently of a kind which affords little protection to the company in times of financial stress. Much is to be said in favour of the plan, upon which so many business men insist, of investing a portion of the amount representing the reserve in sound interest-bearing securities which are easily realizable should occasion demand. For although a successful undertaking could earn, say 8 per cent, or more, on its reserves, by employing them as capital in the development of the business, as compared with 4 to 4½ per cent in sound investments, yet it must be remembered that where the reserve is intended as a safeguard against unforeseen disasters, a fund which is not ready to hand at the time of difficulty is useless.

Other things being equal, a business which has invested its reserves in goods, or extensions, etc., is undoubtedly stronger than one which has no reserves at all. But the reader has only to consider, say, a retail store which has invested its reserves in an abnormally high seasonal stock of goods, on which Purchase Tax of 100 per cent has been paid. If an unexpected government order abolishes the Purchase Tax on those goods, the store will be faced with the difficulty of trying to sell them in competition with any other store which purchases similar goods without any Purchase Tax. Quite unexpectedly, it may therefore have to bear the loss of all the Purchase Tax paid on those goods, in order to write them down to a price at which the public will buy them. In such cases the value of an easily realizable reserve fund can be readily appreciated.

Reserve Invested Outside Business

If the reader will refer to Example 16 he will find a typical case of the outside investment of reserve funds. The list of securities in which the funds have been placed is attached to the published balance sheet. The company's reserves have been created for various purposes, viz. an Insurance Fund of £12,836 against sundry risks; a General Reserve of £80,000 against contingencies; a Reserve of £50,000 against the additional cost of replacing the fixed

Example 16.—Reserve Funds Separately Invested

BALANCE SHEET. 31ST DECEMBER, 19..

Corresponding figures for last year £	£			£	£
		CAPITAL AND RESERVES			
		Share Capital Authorized and Issued—			
	xxx,xxx	100,000 7% Preference Shares of £6 each, fully paid		600,000	
	xxx,xxx	200,000 Ordinary Shares of £4 each, fully paid		800,000	
x,xxx,xxx					1,400,000
	xx,xxx	General Reserve		80,000	
	xx,xxx	Transferred from Profit and Loss Account		20,000	
xx,xxx					100,000
xx,xxx		Reserve for the additional replacement cost of Fixed Assets			50,000
xx,xxx		Insurance Fund			12,836
x,xxx		Profit and Loss Account, balance carried forward			3,587
x,xxx,xxx					1,566,423
		SECURED LIABILITIES			
	x,xxx,xxx	First Mortgage 4½% Debenture Stock, fully paid (of which £35,655 is held by a nominee for the Company)		1,000,000	
	xxx,xxx	"B" Mortgage 4½% Debenture Stock, fully paid (part of an authorized issue of £250,000, of which £41,181 is held by a nominee for the Company)		200,000	
x,xxx,xxx					1,200,000
		CURRENT LIABILITIES			
	xx,xxx	Sundry Creditors		73,955	
	x,xxx	Provision for depreciation of Quoted Investments		10,160	
	xx,xxx	Provision for current U.K. Taxation		36,827	
		Proposed final dividends (net)—			
	xx,xxx	On Preference Shares	11,025		
	xx,xxx	On Ordinary Shares	8,400		
				19,425	
xxx,xxx					140,367
£x,xxx,xxx					£2,906,790

	£	£	Corresponding figures for last year £	£
FIXED ASSETS				
Freehold Land (at cost)		950,000		xxx,xxx
Buildings, Machinery and Plant (at cost)	389,409		xxx,xxx	
Additions during the year (at cost)	10,667			
	400,076			
Less Depreciation written off to date	109,336		xx,xxx	
		290,740 (A)		xxx,xxx
Steamers, Barges and Rolling Stock (at cost)	186,702		xx,xxx	
Less Depreciation written off to date	20,136		xx,xxx	
		166,566 (A)		xxx,xxx
Goodwill (at cost)		870,000		xxx,xxx
Trade Investments (at cost)		79,508		xx,xxx
		2,356,814		x,xxx,xxx
CURRENT ASSETS				
Stock of Salt at works, estimated as per Survey Sheets certified by the Managers, and in Transit and Abroad, on basis of cost	74,008		xx,xxx	
Stocks of Fuel and Material certified by the Managers	52,079		xx,xxx	
Sundry Debtors	138,336		xxx,xxx	
Sundry Debit Balances and Payments in Advance	4,242		x,xxx	
Bills Receivable	4,400		—	
Quoted Investments, as per detailed schedule attached to the Balance Sheet, at cost	131,525		xxx,xxx	
(Market Value, as per detailed schedule attached £121,365)			(xxx,xxx)	
Company's Debenture Stock, at cost—				
£35,655 4½% First Mortgage	35,655		xx,xxx	
£41,181 4½% "B" Mortgage	41,181		xx,xxx	
Cash at Bankers and in Hand	68,550		xx,xxx	
		549,976		xxx,xxx
		£2,906,790		£x,xxx,xxx

Assets (A) at current inflated prices; and a provision of £10,160 against possible losses on the investments. The actual "Reserves," therefore, amount to £152,996, and they are truly "Funds" just so far as there are realizable assets specifically available for their service. It will be observed that the company's outside investments *cost* £131,525, but their *market* value at the date of the balance sheet is only £121,365 (hence the reserve of £10,160).

It is in the directors' favour that out of the year's profits there was transferred a further £20,000 to reserve when they might have won a rather dear blessing from the ordinary shareholders by distributing this amount in cash as a 5½ per cent dividend. As a matter of fact, the transfer to the reserve involved nothing more than a book entry, reducing the profit and loss figures by £20,000 and adding it to the "General Reserve Fund" of £80,000 higher up in the balance sheet, but the real effect was to retain in the business the said sum of £20,000 which in the alternative case would have been paid out of the company's cash balances.

It ought now to be quite clear that when an allocation of profit is made to the reserve, no fresh assets are created, but that an equivalent amount of assets is conserved; also that the availability of the reserve to meet emergencies depends entirely in every case on the marketability or loan value of the assets.

Reserve Invested in Business

In Example 17 we have a fairly typical case of reserves invested "in the business." They are three in number: a Reserve *Account* of £80,278; a General Contingency *Fund* of £10,000; and a Licence Insurance *Fund* of £13,000; total, £103,278. On the face of it there appears no reason why two of these reserves should be termed "Funds" rather than "Accounts," for the assets side reveals no funds available for setting off against them, i.e. if we omit the sundry debtors, loans, and cash, which are required for current business purposes.

Where, then, are these reserves? Let the reader regard the matter thus: The total "Capital and liabilities," *on paper*, are equal to the total "Assets"—they balance each other. Consequently, any part of the one total may be measured off against an equal part of the other total. Now when the reserve is separately invested, the amount of the item "Reserve" on the liabilities side is balanced by the amount of the item "Investments" on the assets side. But if the reserve is not separately invested, there is no such definite pairing of particular "liabilities" against particular "assets," and the reserve must be regarded as finding its equivalent somewhere in

the general total of the assets; it is "in the business." In judging the value of the reserves, therefore, the reader must take into consideration the value of the assets.

It is a common practice among banking and discount companies and, also, assurance companies to build up secret reserves, i.e. accumulated profits which are not disclosed in the accounts published. Under Paragraph 23 and 24 of Schedule VIII of the Companies Act, 1948, they are permitted to do this. But no other companies are allowed to do so by the Act.

There are several ways of doing this, e.g. (1) Excessively depreciating the balance sheet value of the premises. (2) Omitting assets altogether from the balance sheet (writing off furniture). (3) Over-providing for debt contingencies. A good example of a secret reserve may be seen in the balance sheet of the Bank of England where nothing is taken into account for the value of the Bank's premises.

Example 17.—Reserves "I

BALANCE SHEET, 30TH

Corresponding figures for last year £	£			£	£
		CAPITAL RESERVES AND UNDISTRIBUTED PROFITS			
		Share Capital, Authorized and Issued—			
	xxx,xxx	15,000 Ordinary Shares of £10 each		150,000	
	xxx,xxx	30,000 6% Cumulative Preference Shares of £10 each		300,000	
xxx,xxx					450,000
		Revenue Reserves and Undistributed Profits—			
	xx,xxx	Revenue Account		80,278	
	xx,xxx	General Contingency Fund		10,000	
	xx,xxx	Licence Insurance Fund		13,000	
	xx,xxx	Profit and Loss Account		12,096	
xxx,xxx					115,374
xxx,xxx					565,374
		MORTGAGES AND SECURED LOANS			
	xxx,xxx	4½% Mortgage Debenture Stock		100,000	
	xxx,xxx	4% Mortgage Debenture Stock	£250,000		
		Less Redeemed by Debenture Trustees and cancelled			
	x,xxx		9,216		
	xxx,xxx			240,784	
	x,xxx	Interest accrued to date (net)		3,709	
	xxx,xxx			344,493	
	xxx,xxx	Secured Loans	£165,875		
	x,xxx	Interest accrued to date (net)	1,380		
	xxx,xxx			167,255	
xxx,xxx					511,748
		CURRENT LIABILITIES AND PROVISIONS			
	xx,xxx	Sundry Creditors		22,397	
	xx,xxx	Provision for Current Taxation		11,261	
	xx,xxx	Proposed Final Dividends (net)		12,600	
xx,xxx					46,258
£x,xxx,xxx					£1,123,380

We hope it is now quite unnecessary to point out that the "Reserve," whether styled an "Account" or a "Fund," is not a kind of new and separate body of assets placed on the liabilities side through some accountancy juggle. If this remark is as superfluous as it ought to be, we would only say, in justification of its insertion, that we have seen in a little volume issued by an investment "expert," an example of the method of calculating the assets of a balance sheet, wherein the simple-minded investor was directed to add the reserve fund to the items appearing on the assets side.

Profit and Loss Account

We may conclude this brief survey of the principal features of the modern balance sheet by a consideration of the profit and loss account, which is generally the first item to receive the notice of the shareholder. The details of this account, which gives a summary

vested in the Business"

SEPTEMBER, 19..

	£	£	*Corresponding figures for last year* £	£
FIXED ASSETS				
Freehold Land and Brewery Buildings, Maltings, Bottling Stores, Wine and Spirit Stores, Garages, Cooperage, and Offices, at cost	200,000		xxx,xxx	
Less Depreciation to date	42,596	157,404	xx,xxx	xxx,xxx
Freehold and Leasehold Licensed Houses and Fixtures, at cost	900,000		xx7,xxx	
Less Depreciation to date	150,690	749,310	xxx,xxx	xxx,xxx
Other Properties at cost	80,000		xx,xxx	
Less Depreciation to date	26,051	53,949	xx,xxx	xx,xxx
Fixed Plant and Machinery at cost	50,000		xx,xxx	
Less Depreciation to date	9,307	40,693	x,xxx	xx,xxx
Office Furniture at cost	4,000		x,xxx	
Less Depreciation to date	1,250	2,750	x,xxx	x,xxx
Vehicles and Rolling Stock, at cost	12,000		xx,xxx	
Less Depreciation to date	2,320	9,680	x,xxx	x,xxx
Goodwill—				
As at the formation of the Company	49,000		xx,xxx	
Additions—New Businesses acquired	14,552		xx,xxx	
	63,552		xx,xxx	
	63,552	—	xx,xxx	—
Trade Investments in other companies, at cost		2,284		x,xxx
		1,016,070		x,xxx,xxx
CURRENT ASSETS				
Stocks in Brewery, at Wine and Spirit Stores and in Managed Houses, passed by the directors at	72,175		xx,xxx	
Sundry Debtors	19,930		xx,xxx	
Loans to Licensed Houses	3,167		xx,xxx	
Cash in Hand and at Bankers	12,038	107,310	x,xxx	xx,xxx
		£1,123,380		£x,xxx,xxx

Example 18.—Dividin

BALANCE SHEET

Corresponding figures for last year £	£		£	£	£
		CAPITAL			
		Authorized—			
	xxx,xxx	20,000 6% Preference Shares of £5 each		100,000	
	xxx,xxx	20,000 Ordinary Shares of £5 each		100,000	
	£xxx,xxx			£200,000	
		Issued and fully paid up—			
	xx,xxx	10,000 6% Preference Shares of £5 each		50,000	
	xxx,xxx	20,000 Ordinary Shares of £5 each		100,000	
xxx,xxx					150 00
x,xxx		Profit and Loss Account, balance carried forward			1,32
xxx,xxx					151,32
		SECURED LIABILITIES			
	xxx,xxx	5% Debenture Stock		100,000	
	xxx	Interest Accrued to date (net)		656	
xxx,xxx					100,65
		CURRENT LIABILITIES			
	xx,xxx	Sundry Creditors		13,702	
	x,xxx	Loan from Bank		5,000	
	x,xxx	Deposit Accounts		8,465	
	x,xxx	Provision for Current U.K. Taxation		5,073	
		Proposed Final Dividends—			
	xxx	On Preference Shares (net)	788		
	x,xxx	On Ordinary Shares (free of tax)	2,000		
	x,xxx			2,788	
xx,xxx					35,028
£xxx,xxx					£287,012

PROFIT AND LOSS ACCOUNT FOR THE

£			£
x,xxx	To Directors' Fees and Emoluments		1,338
x,xxx	,, Depreciation		800
x,xxx	,, Debenture Interest for the year (net)		2,625
x,xxx	,, U.K. Income Tax payable during the year		5,073
xxx	,, Remuneration of Trustees for Debenture Holders		200
xxx	,, Auditors' Fees and Remuneration		463
	,, Preference Dividends—		
	Interim Paid (net)	788	
	Final Proposed (net)	788	
x,xxx			1,576
	,, Interim Dividend paid on Ordinary Shares for the first half of the year at the rate of		
x,xxx	6% p.a. (free of tax)		3,000
x,xxx	,, Proposed Final Dividend on Ordinary Shares at 4% p.a. (free of tax)		2,000
x,xxx	,, Balance carried forward, as per Balance Sheet		1,328
£xx,xxx			£18,403

of the revenue and the expenses of the business, are not shown in the balance sheet itself, but are set out in a separate account, attached to the balance sheet. Here let the reader be on his guard against a superficial difficulty. For if the business is an unsuccessful one, the profit and loss account will appear on the "Assets" side; whilst ii it is a success, the profit and loss account will show on the "Liabilities" side of the balance sheet. This is confusing, but it is correct accounting, and the reason, roughly put, is that the profit and loss account represents the difference between the "Assets"

Profit "To the Hilt"

31ST JANUARY, 19..

				Corresponding figures for last year	
		£	£	£	£
FIXED ASSETS					
Goodwill, at cost			47,000		xx,xxx
Freehold Land, at cost		63,982		xx,xxx	
Additions during the year, at cost		500		xxx	
			64,482		xx,xxx
Plant, Machinery, at cost		36,166		xx,xxx	
Additions during the year, at cost		62,677		xx,xxx	
		98,843		xx,xxx	
Depreciation Account—					
As per last Balance Sheet	10,000			x,xxx	
Amount added this year	800			xxx	
		10,800		xx,xxx	
			88,043		xx,xxx
			199,525		xxx,xxx
CURRENT ASSETS					
Loose Tools, valued at cost less Depreciation at 10%		4,630		x,xxx	
Book Debts (After deducting Reserve against Doubtful Debts and Contingencies)		25,294		xx,xxx	
Goods in Stock as per Inventories (At or under Cost as certified by managers)		50,468		xx,xxx	
Cash at Bankers, in Hand, and on Deposit		7,095		x,xxx	
			87,487		xx,xxx
			£287,012		£xxx,xxx

YEAR ENDING 31ST JANUARY, 19..

	£	£
By Balance from last year	1,206	x,xxx
,, Profit on Trading for the year	17,156	xx,xxx
,, Rents and Transfer Fees received	41	xx
	£18,403	£xx,xxx

and "Liabilities," so that when the "Assets" are larger and there is a profit, it appears under the "Liabilities" in order to balance the two sides, and vice versa.

Losses showing on the Assets side will be found in Examples 1 and 14 (see pages 2 and 37); Example 18 (which appears above) represents the account in the place it should normally occupy. In the latter case, the profit and loss account in the balance sheet refers us to the more detailed account of the same name shown below, from which we note that the gross profit for the year on

trading and from other sources is £17,197, and the balance brought forward is £1,206. Note that there is no Reserve Fund, but only a Depreciation Account, the amount of which, viz. £10,800, is deducted from the book value of the plant and machinery included in the total of £199,525. We mention this in connection with the profit and loss account because of the small profit remaining (viz. £3,328) after paying Debenture Interest, Preference Dividend, and Interim Dividend at 6 per cent (or an actual dividend of 3 per cent) on the Ordinary shares, and also because out of that amount the directors paid a final dividend at the rate of 4 per cent per annum (*vide* directors' report), leaving a balance of £1,328 to be carried forward. All this has been paid out to the shareholders after providing during the year what would appear to be a very meagre sum for depreciation (£800), having regard to the total amount of the fixed assets. A company which is now in its nineteenth year, and possesses no reserve, which holds deposits in trust and owes money to its bankers, might be expected to refrain from the dangerous policy of dividing up so closely its available profits.

Profit and Loss Account—Important Facts to be Stated

Certain facts with reference to the profit and loss account ought never to be missing or obscured. These are: (*a*) The actual profit for the period of trading; (*b*) what has been deducted from the trading profit to cover depreciation, debenture interest, and other provisions; (*c*) whether Income Tax has been provided for, merely on the basis of the legal liability arising during the year, or whether a reserve has been made to cover the estimated full liability that will arise in future years on the profits disclosed; (*d*) what amounts have been set aside to reserve; (*e*) any abnormal windfalls brought into credit, or any amounts brought into credit out of reserves built up in past years; (*f*) the balance of profit brought forward from the previous year; (*g*) the amount of dividends paid and proposed. All these items must, under the Companies Act, 1948, be clearly disclosed on the profit and loss account, together with details of the directors' fees, emoluments and pensions, details of the auditors' remuneration as well as notes on other matters, details of which can be seen in Appendix II.

It will thus be seen that the bald statement in the balance sheet, that the balance of profit and loss account is so much, is valueless from the point of view of assessing the worth of the business, and its ability to trade profitably. What is required to be known is the net profit on the year's working, and a clear statement of any addition to or subtraction from that sum. Thus, if after a year of bad trade,

a book entry is made transferring a portion of the reserve to the credit of the profit and loss account, so as to enable a dividend to be paid, it is certainly a matter of concern to both shareholders and creditors. Bearing these hints in mind, the investor and the creditor alike should have no difficulty in arriving at a fair idea of the position of an undertaking as shown by its balance sheet and profit and loss account, notwithstanding the fact that main points only have been touched upon.

CHAPTER V

ANALYSING BALANCE SHEETS

It is now proposed to apply the information and methods given to the analysis of a modern business balance sheet. By way of preface, however, let it be at once stated that the figures for one single year would be practically useless as the basis for a sound judgment. They certainly show the state of affairs on a given date, but they would afford no comparison with the past, and would not disclose whether that state represents progress or decline. For this reason the Companies Act, 1948, includes the requirements of showing in parallel columns the figures of the previous balance sheet and profit and loss account.

In order to assist in the interpretation of the figures, some companies take the trouble to append to the published accounts, tabulations showing the main items over the last few years—the greater the range of items covered and the greater the number of years included, the better for the investigator.

Balance Sheet Analysis

For the purpose of indicating the sort of information that can be extracted from a study of the comparative balance sheet figures over a period of years, we have selected the balance sheet given as Example 19, because it presents features of interest, as well as of some difficulty.

In the first place, it should be noted that we are primarily considering the balance sheet although some reference will be made to the trading and profit and loss account attached to the balance sheet.

Let us take, first, a general survey of the financial position. To do this, the balance sheet items are grouped under their respective heads, namely, the Assets under "Fixed," "Intangible," "Circulating," and "Liquid", and the Liabilities divided into those due to the "Public" and those to the "Shareholders." We shall then see at a glance the nature of the company's assets and the extent of its liabilities.

To facilitate reference, the totals of the various groups are printed in heavier type in Example 20, where the balance sheet figures for the last three years are compared. It will be seen that, taking the figures at their face value, while the intangible assets

Example 19

BALANCE SHEET. 31ST DECEMBER, 1951

Corresponding figures for 1950 £	Corresponding figures for 1950 £		1951 £	1951 £
		SHARE CAPITAL		
		Authorized and Issued—		
	300,000	300,000 5% Cumulative Preference Shares of £1 each	300,000	
	200,000	200,000 Ordinary Shares of £1 each	200,000	
500,000				500,000
		REVENUE RESERVES		
30,000		General Reserve	30,000	
		Add Transfer from Appropriation Account	30,000	
				60,000
6,750		Reserve for future taxation		21,375
36,992		Profit and Loss Account, balance carried forward		31,530
573,742				612,905
		SECURED LIABILITIES		
	300,000	5¼% First Mortgage Debenture Stock	300,000	
	4,537	Interest accrued (net)	4,331	
304,537				304,331
		CURRENT LIABILITIES AND PROVISIONS		
	30,490	Creditors	22,488	
	14,226	Depositors	13,955	
	1,651	Provision for current taxation	7,947	
	4,125	Proposed dividends (net)	19,687	
50,492				64,077
£928,771				£981,313

	1951 £	1951 £	Corresponding figures for 1950 £	Corresponding figures for 1950 £
FIXED ASSETS				
Freehold Land, at cost	290,784		283,642	
Additions during the year	6,551		7,142	
		297,335		290,784
House Property, at cost	199,642		199,642	
Less Charge on part of House Property	17,176		17,520	
		182,466		182,122
Plant, Machinery and Buildings, at cost	138,813		138,813	
Less Depreciation to date	41,382		36,012	
		97,431		102,801
Goodwill, at cost	92,044		92,044	
Less Amount written off	8,728		7,637	
		83,316		84,407
		660,548		660,114
CURRENT ASSETS				
Investments, at cost—				
£22,500 2½% Consols	18,647		19,048	
£10,900 3% Australia	9,224		9,224	
(Market Value: £22,950)		27,871		28,272
Cash		60,104		13,060
Bills Receivable		1,352		799
Stock of Produce and Materials, at cost or under	117,375		112,389	
Stores, at cost	3,378		2,964	
		120,753		115,353
Book Debts	129,276		127,013	
Less Reserve for Discounts, Bad Debts, Losses on Exchange, for Empties returned but unclaimed, and for Packages in the hands of Customers to be returned	19,742		17,321	
		109,534		109,692
Insurance Premiums and other payments in advance		1,151		1,481
		£981,313		£928,771

remain stationary, there is for the year 1951 a slight increase in the totals of the fixed and circulating assets, and a doubling of the liquid assets. The increases in the last two classes of assets are a good sign, but one test must be applied before they can be accepted as an indication of progress. Obviously, the circulating assets could easily be made to show an increase by the purchase and taking into stock of large quantities of stores just before the closing of the books, and the liquid assets could be swollen by the simple method of not paying the outstanding accounts. But observe that in both cases creditors would remain as a result, and consequently the item of "Liabilities to the Public" would be increased. In the present instance our table shows that whereas these creditors stood at £370,096 at December, 1951, or about £21,000 above the corresponding figures of 1949, the circulating and liquid assets increased during the same period by £52,000. This is eminently satisfactory.

Margin of Capital

The same table enables us to ascertain the margin of capital on which the company is carrying on its business. If we deduct the amount of the debentures or fixed debt (£300,000) from the "Liability to the Public," we find that the actual liability is £70,096. But of this total, the reserve for future taxation of £21,375 will not be payable until next year. This leaves current debt (including deposits) of £48,721. To satisfy these creditors, we have all the circulating and the liquid assets. Thus—

	£
Circulating Assets	232,790
Liquid Assets	87,975
	320,765
Less—Current Liabilities (as above) .	48,721
	272,044
Deduct—Dividends Outstanding . .	19,687
Working Capital	£252,357

The company's working capital was, therefore, over a quarter of a million sterling at December, 1951.

Hitherto we have accepted the company's figures at their book value. Let us now look at the items rather more closely. By far the largest figures in the accounts are those representing the fixed assets, namely, Freehold Land, House Property, and Plant, Machinery and Buildings. Together these total £577,232, which is 64 per

Example 20.—Items Rearranged

	Dec., 1949	Dec., 1950	Dec., 1951
	£	£	£
Liabilities to the Shareholders—			
5% Cumulative Preference Shares of £1 each	300,000	300,000	300,000
Ordinary Shares of £1 each	200,000	200,000	200,000
General Reserve	30,000	30,000	60,000
Profit and Loss Account balance carried forward[1]	36,249	36,992	31,530
Proposed final Preference Dividend (net)	4,125	4,125	3,937
Proposed Ordinary Dividend (net)	8,250	—	15,750
	578,624	**571,117**	**611,217**
Liabilities to the Public—			
5½% First Mortgage Debenture Stock	300,000	300,000	300,000
Accrued Debenture Interest (net)	4,537	4,537	4,331
Creditors	16,069	30,490	22,488
Depositors	13,829	14,226	13,955
Provision for current taxation	1,131	1,651	7,947
Reserve for future taxation	13,500	6,750	21,375
	349,066	**357,654**	**370,096**
	£927,690	£928,771	£981,313

	Dec., 1949	Dec., 1950	Dec., 1951
	£	£	£
Fixed—			
Freehold Land	283,742	290,784	297,335
House Property	181,791	182,122	182,466
Plant, Machinery and Buildings	108,488	102,801	97,431
	574,021	**575,707**	**577,232**
Intangible—			
Goodwill	**85,498**	**84,407**	**83,316**
Circulating—			
Bills Receivable	714	799	1,352
Stocks and Stores	115,095	115,353	120,753
Book Debts	104,153	109,692	109,534
Payments in Advance	1,441	1,481	1,151
	221,403	**227,325**	**232,790**
Liquid—			
Investments	23,725	28,272	27,871
Cash	23,043	13,060	60,104
	46,768	**41,332**	**87,975**
	£927,690	£928,771	£981,313

[1] This does not represent the year's profit, but only the balance unappropriated, which is carried forward at the end of the year.

cent of the company's entire assets. (The intangible assets are, of course, omitted.)

Depreciation

The first noticeable feature is that no depreciation whatever is shown in the balance sheet in respect of the first-named assets, which are valued at nearly half a million sterling. It is true that the value of the Freehold Land may not change, but the position regarding the House Property is not altogether clear. Here, then, is a point requiring investigation. Turning to the directors' report which accompanies the balance sheet, we learn that £12,284 has been spent in maintaining the whole of the fixed assets during the year, which is a trifle over 2 per cent. How this compares with previous years is shown in the following table—

DEPRECIATION, ETC.

	1949	1950	1951
	£	£	£
Freehold Land	283,742	290,784	297,335
House Property	199,642	199,642	199,642
	483,384	490,426	496,977
Less Charge on Part of House Property	17,851	17,520	17,176
	465,533	472,906	479,801
Plant, Machinery and Buildings	108,488	102,801	97,431
	574,021	575,707	577,232
Amounts (as per directors' report)—			
Renewal and Maintenance of House Property, Plant, Machinery, and Buildings	12,436	13,880	12,284
Depreciation of Plant, Machinery and Buildings (shown in Profit and Loss Account)	5,325	5,687	5,370

The question at once arises as to the value of these assets. Since the balance sheet contains no suggestion, the investigator must turn to standard books of reference, and it is important he should know where to find his information. The work most commonly consulted in difficulties such as this is *The Stock Exchange Official Year Book*. From this we learn certain facts. We note that the company was formed in 1943 to take over an existing business.

Mortgage Debentures

We also note that the £300,000 debenture stock already alluded to was issued in that year, and is secured by mortgage on the freehold land, buildings, and house property taken over by the company in 1943.[1] Now it is probably well within the mark to assume that, at the time of issue, the security was valued (professionally) at least at one and a half times the amount of the issue. On this basis the above properties were worth £450,000 in 1943, which is respectably near the balance sheet figure of £497,000.

Fortunately we have a check on this estimate. *The Times* publishes semi-annual volumes of reprints of prospectuses which have appeared in its pages. Turning to the issues for January to June, 1943, we should have found the facts we require, for the prospectus of this company contains the following item—

> "Freehold land, and House Property at . . . . and . . . . . ., described in the valuation of Messrs. . . . . at £447,081."

This was ten years ago; in the meantime further expenditure has raised it by another £50,000. But although it is to be presumed that the properties have been maintained out of the annual cost shown above, such cannot prevent their "depreciation," and sooner or later the debenture-holders, who get no increased profits in good years, may require the business to protect them by creating a reserve fund out of annual profits as provision against the day when their specially hypothecated security will require rebuilding.

As it is important to the investor to know all he can in connection with the valuing of assets, we may here indicate another line of inquiry. Let the investigator take the statistical records of the Stock Exchange quotations of this company's debentures. There he will find, say, the following carefully compiled data—

EXTREME QUOTATIONS

	1949		1950		1951		Since Dec., 1944	
	Hgst.	Lwst.	Hgst.	Lwst.	Hgst.	Lwst.	Hgst.	Lwst.
5½% Deb. Stock .	108	104	106	103	102	99	105	90
Average price .	106		104½		100½		97½	

[1] Also by a floating charge on the assets.

The significance of these figures will be better understood if it be remembered that debentures have a regular interest and, consequently, are not sought by speculators, so that their market price more accurately reflects their real value than does that of shares, in which the uncertainty as to the rate of dividend induces an inevitable element of speculation in the price bid for the shares on the market.

From the table it will be seen that since 1944 the price of this company's debenture stock rose steadily from the time they were issued until 1949, and even now are standing above par. It might seem, therefore, that the security could be considered as being a first-class investment. But a hasty conclusion should not be drawn and two points of view should be considered.

It must be remembered that during the period when cheap money was being deliberately created by the policies pursued by the Chancellor of the Exchequer of that time, the general level of prices of debenture stocks rose steadily. The fall in the value of money led to the withdrawal of money from the banks. In an endeavour to find a more profitable channel than that afforded by the banks, investors put money in debenture and similar stocks. This led to the appreciation of such stocks until they yielded a much lower rate of interest on the money invested. With the change of government, a new Chancellor of the Exchequer began a policy in 1951 of making money more expensive. As a result interest rates increased, and so the fall in price of these debentures, shown in 1951, is not necessarily a result of any fall in their value. It is a result of a general shift in the level of prices of all similar stocks.

Furthermore, these particular debentures are secured not only by a trust deed on specific freehold property, but are a floating charge on the remainder of the assets. On balance, we should say that the security may be considered a sound one, and that the yield at present prices justifies an investment in the debentures.

Trading Results

We must now consider the trading results, and, in particular, note the distribution of the surplus profits. Our reference books give us the dividends paid since the inception of the company as follows—

DIVIDENDS—PER CENT

1944	1945	1946	1947	1948	1949	1950	1951
5	7½	7½	7½	7½	7½	nil	15

From the published profit and loss account, we show below the trading profits and how they were disposed of.

It will be observed that the net profit for 1950 shows a heavy fall from that of 1949 (due to high prices of raw materials), but that the net profit for 1951 makes a leap upwards from £15,743 to £69,538. Let it be remarked that wide fluctuations are very liable to occur in the profits of concerns dependent largely upon crops, or other basic

DISPOSITION OF PROFIT

	1949	1950	1951
	£	£	£
Trading Profit for the year	89,388	75,557	111,082
Less—			
Directors' Fees and Pensions	1,593	1,550	1,575
Depreciation of Plant, Machinery and Buildings	5,325	5,687	5,370
Amount written off Goodwill	1,091	1,091	1,091
5½% Debenture Interest (net)	9,075	9,075	8,662
Auditors' Remuneration	1,160	1,051	1,120
Current U.K. taxation	31,632	41,360	23,726
	49,876	59,814	41,544
Net Profit for the year	39,512	15,743	69,538
Add Balance from previous year	31,737	36,249	36,992
Profit available for distribution	£71,249	£51,992	£106,530
Proposed distribution—			
5% Cumulative Preference Shares			
Interim Dividend Paid (net)	4,125	4,125	3,938
Final Dividend Proposed (net)	4,125	4,125	3,937
Proposed Ordinary Dividend (net)	8,250	—	15,750
General Reserve	5,000	—	30,000
Reserve for future taxation	13,500	6,750	21,375
Balance carried forward	36,249	36,992	31,530
	£71,249	£51,992	£106,530

raw materials, for a scanty world harvest, or stockpiling by one section of the world due to a fear of shortage when war threatens, can push prices to abnormal and uneconomic levels. For the ordinary industrial user, this means higher manufacturing costs, frequently without correspondingly increased selling prices.

It is satisfactory to note from these figures that the directors do not adopt the policy of dividing profits "up to the hilt," for the balance "carried forward" in each year is well over £30,000. Further, advantage was taken of the fine result of 1951 to transfer

£30,000 to the Reserve Account (making it £60,000), thus keeping it in the business. This is sound policy and the next balance sheet may show a considerable increase in the investments now standing in the accounts at £27,871.

Of the remaining items, it will be noticed that the company holds about £14,000 on behalf of depositors, but as the amount is small and the margin of working capital is large, there is no danger to be apprehended in that respect. Again, in 1943 the company paid £92,044 for goodwill according to the prospectus; in 1951 it stood at £83,316. From this it appears that it is being written off at the rate of £1,091 per annum. At this same rate, it would take another 78 years to extinguish it. However, it must be borne in mind that if the company continues to earn satisfactory profits, this asset does not in fact diminish in value.

In conclusion, it need scarcely be said that each balance sheet and each class of balance sheets have peculiarities which defy anything like a too formal analysis. Nevertheless, the general principles of attacking the problem which have here been briefly illustrated are of value to the investigator and will enable him to get a grip of the essential facts. If he will take the accounts of a few companies in which he is interested and dissect them along the lines indicated, he will find it not only a useful but a fascinating and profitable study.

CHAPTER VI

FACTS TO BE CONSIDERED BY CREDITORS AND INVESTORS

It has been already indicated that the interests of the trade creditor are to some degree antagonistic to those of the investor. For instance, the existence of partly-paid shares affords a measure of protection to the creditor, because he knows that, in an emergency, the directors or the liquidator are bound to call up the balance outstanding on the shares and also that the shareholders are bound to pay. Thus the uncalled capital is an asset from the point of view of the creditor and a liability from the standpoint of the shareholder. But if the share capital be fully paid, the trade creditor is, next to the shareholders themselves, the heaviest loser in the event of the company getting into difficulties. Of course, he may have been sufficiently well informed and forceful to have obtained some security against his account, but if he has not done so, his position is unenviable. Hence, in addition to employing the usual trade agencies for obtaining secret information, he should study the balance sheet with alert and critical mind. He must take nothing for granted. He should liberally discount the assets not easily realizable on a forced sale, and the more his suspicions are confirmed, the heavier should be the discount, for there is a kind of natural order in which assets are disposed of. First, the cash disappears in the endeavour to stave off the crisis; then the investments are thrown on the market and sold—the loss depending on the nature of the security and the "width" of the market. The bills receivable will then be discounted and, if possible, an advance will be obtained on any good asset. Further, the stock will be sold at a sacrifice, after which there is, as a rule, nothing left save the fixed assets—the plant, machinery, buildings, and real estate. But probably long before this final stage is reached, the trustee for the debenture-holders will have stepped in between the remaining assets and the ordinary creditor, and the latter will be constrained, after months of weary waiting, to accept a share of such crumbs as may fall from the debenture-holder's table.

Position of Debenture-holder

On the other hand, the debenture-holder, holding the most favoured position, has only to see that the company maintains his

Example 21.—Reserve Use

BALANCE SHEET. 31ST

Corresponding figures for last year £	£			£	£
		SHARE CAPITAL			
		Authorized and Issued—			
		15,000 5% Cumulative Preference Shares of £10 each, fully			
	xxx,xxx	paid		150,000	
	xxx,xxx	150,000 Ordinary Shares of £1 each, fully paid . .		150,000	
xxx,xxx					300,000 (i)
		REVENUE RESERVES AND UNDISTRIBUTED PROFITS			
	xx,xxx	Revenue Reserve Fund	95,000		
		Less **amount taken in reduction of Capital**			
	xx,xxx	**Expenditure** *contra* . . . . . (ii)	91,947		
	x,xxx		3,053		
	—	Amount added this year	10,000		
				13,053	
	xx,xxx	Working Capital Reserve . . . . (iii)		15,000	
	x,xxx	Staff Pension Fund . . . . . . (iii)		2,136	
	xx,xxx	Leasehold Redemption Fund . . . . (iii)	22,754		
	x,xxx	*Add* Transfer from Profit and Loss Account .	1,300		
	xxx	Income on Investments	812		
	xx,xxx			24,866	
	xx,xxx	Profit and Loss Account, balance carried forward		19,091	
xx,xxx					74,146
		DEBENTURES			
		Perpetual 4% Debenture Stock secured by a First Mortgage on the Freehold and Leasehold Properties and by a floating charge on the undertaking and general assets, of which			
	xxx,xxx	£23,800 is held by the Trustees for the Debentur Holders		225,000 (i)	
	x,xxx	Debenture Interest accrued (less tax)		2,362	
xxx,xxx					227,362
		CURRENT LIABILITIES			
	xx,xxx	Sundry Creditors		33,798	
	xx,xxx	Provision for Current Taxation		10,165	
		Proposed final dividends—			
	x,xxx	On Preference Shares (less tax)		1,969	
	x,xxx	On Ordinary Shares (less tax)		7,875	
	xxx	Unclaimed Ordinary Dividends		222	
xx,xxx					54,029
£xxx,xxx					£655,537

hypothecated assets in good condition and that there is a sufficient margin of security over the amount of the debenture loan. If he also possesses a "floating charge" on the company's other assets, he will watch that these assets are not disposed of except in legitimate trade. It should be noted that a floating charge is by no means so satisfactory a security as a special hypothecation of selected assets, the reason being that in the first case the assets, fixed or otherwise, may be sold by the company, while in the second the mortgaged property may not be parted with except with the debenture-holders' consent.

In the large majority of cases, debentures are secured on the land, buildings, plant and machinery belonging to the undertaking. Of these, land and buildings form by far the largest proportion. The difficulty, which time after time has beset debenture-holders, is that the huge buildings which have been erected for the especial purposes of the business are often absolutely unsaleable in the event of liquidation, because there is no firm of sufficient magnitude

to Write Down Assets

DECEMBER, 19..

			Corresponding figures for last year	
	£	£	£	£
FIXED ASSETS				
Purchase Price of the Properties and Capital Expenditure Account—				
As per last Balance Sheet, at cost	616,947		xxx,xxx	
Less **Amount of Reserve Fund taken in reduction** *contra* (ii)	91,947		xx,xxx	
		525,000(i)		xxx,xxx
Trustees for Debenture Holders—				
Leasehold Redemption Fund £23,800 Company's 4% Debenture Stock, at cost . . . . (iv)		22,951		xx,xxx
CURRENT ASSETS				
Reserve Fund Investment Account—				
2½% Consols, at cost. (Market value: £16,450) . . (iv)		23,053		xx,xxx
Stocks of Wines, Spirits, Provisions, etc., on hand, at cost . .		55,808		xx,xxx
Sundry Debtors		8,780		xx,xxx
Cash—				
On General Account	8,347		x,xxx	
On Deposit Account	6,000		—	
On Leasehold Redemption Fund . . . . . . (iv)	4,192		x,xxx	
In Hand	1,406		xxx	
		19,94		x,xxx
		£655,537		£xxx,xxx

which requires premises of that nature at the particular time. The reader will perhaps remember the fine hotel which was erected in the heart of London at a cost of well over a million pounds, which passed into a Receiver's hands and was subsequently disposed of for £500,000. Hence, when the business is in difficulties, the directors can and do approach the debenture-holders and say: "You must forbear to press your claims, otherwise we shall wind up the business and you will be left to realize these huge works."

Thus, debenture-holders are frequently forced to join in a reconstruction whereby they sustain a loss of capital or interest, in preference to facing the dreary delay involved in disposing of a costly but burdensome security.

Position of Preference and Ordinary Shareholders

As to the position of the Preference and Ordinary shareholders, it may frankly be said that in most cases of failure, their claims are

Example 22.—Previous Example Rearranged for Analysis

BALANCE SHEET. 31ST DECEMBER, 19..

		£	£
Liabilities to the Shareholders—			
15,000 5% Cumulative Preference Shares of £10 each, fully paid		150,000	
150,000 Ordinary Shares of £1 each, fully paid		150,000	
			300,000
Revenue Reserve Fund	95,000		
Less amount taken in reduction of Capital Expenditure *contra*	91,947		
	3,053		
Amount since added	10,000		
		13,053	
Working Capital Reserve		15,000	
Staff Pension Fund		2,136	
Leasehold Redemption Fund		24,866	
Profit and Loss Account balance		19,091	
			74,146
Proposed final Preference Dividend		1,969	
Proposed final Ordinary Dividend		7,875	
Unclaimed Ordinary Dividends		222	
			10,066
			384,212
Liabilities to the Public—			
Perpetual 4% Debenture Stock secured by a First Mortgage on the Freehold and Leasehold Properties and by a floating charge on the undertaking and general assets	225,000		
Less Stock Purchased by Trustees, *contra* (a)	23,800		
		201,200	
Debenture Interest accrued (net)		2,362	
		203,562	
Sundry Creditors	33,798		
Current Taxation	10,165		
		43,963	
			247,525
			£631,737

	£	£
Fixed Assets—		
Purchase price of properties and Capital Expenditure Account at cost	616,947	
Less amount of Reserve Fund taken in reduction *contra*	91,947	
		525,000
Circulating Assets—		
Stocks on hand at cost	55,808	
Sundry Debtors	8,780	
		64,588
Liquid Assets—		
Reserve Fund Investments, Consols at cost (Market Value: £16,450)	23,053	
Cash on General Account	8,347	
On Deposit	6,000	
In Hand	1,406	
		38,806
		628,394
Intangible and Non-available Assets—		
Debenture Trustees Investments in Company's own Debenture Stock at cost	22,951	
Less Stock, *contra* (a)	23,800	
	849	
Cash on Leasehold Redemption Fund	4,192	
		3,343
		£631,737

not worth consideration, for there is seldom anything left over for their benefit.

Let us now test the position of the creditors and investors of the company whose balance sheet is reprinted as Example 21. Certain features catch the attention at once: (i) The principal asset, viz. the properties, stands at a price (£525,000) which is exactly equivalent to the aggregate amount of Share Capital and Debenture Stock issued. (ii) This figure of £525,000 is reached by transferring £91,947 from Reserve "Fund," presumably to compensate for the fact that there has been no other charge in the accounts for depreciation. (iii) There is a Working Capital Reserve, i.e. profit set aside from time to time, so as to retain money in the business which otherwise might have been distributed in dividends, a Staff Pension Fund, and a Leasehold Redemption Fund. (iv) These funds are invested in Consols, in purchases of the Company's own debenture stock—equivalent to a redemption of same—and £4,192 is in cash.

In Example 22 the balance sheet is rearranged for the purpose of analysis. Of the real creditors of the company, amounting in all to £247,525, we will consider first the position of the debenture-holder, because he is not only a legal creditor, but an investor also. Of the £225,000 debenture stock issued, £23,800 has been bought in by the Trustees, which leaves £201,200 outstanding (compare (*a*)). This stock, plus the accrued interest of £2,362 (net), is secured by a first mortgage on the freehold and leasehold properties, and by a floating charge on the rest of the assets, but the Debenture Trust already held £4,192 of cash on the Leasehold Redemption Fund. The total available assets = £525,000 (Fixed) + £64,588 (Circulating) + £38,806 (Liquid) = £628,394. Thus the Debenture Stock and Interest (£203,562) is secured on over three times its value of assets, *at their face value.* After taking into account the surplus cash £3,343 held by the Debenture Trustees, the balance left = £428,175. The remaining creditors under the heading of "Liabilities to the Public" amount to £43,963. These can easily be met, leaving a margin of £384,212.

Having disposed of the company's outside liabilities, we may now turn to the 5 per cent Preference Shares. These have been issued to the extent of £150,000, and there is a final half-year's dividend of £1,969 due to them. Deducting this from the available balance leaves £232,243 for the Ordinary Shareholders.

The Ordinary Share Capital of £150,000, plus outstanding dividends of £8,097 are covered by assets nearly 1½ times. Ignoring the dividends, each of the £1 Ordinary shares is represented by

assets *of the face value* of £1 11s. We may put the figures in tabular form thus—

	Book Value of Available Assets		Times Covered by Available Assets	Market Price 17th Sept. 19..	Interest or Dividend	Yield per cent
	£	£		£		
Available Assets as per Balance Sheet . . .		628,394				
Debenture Holders . .	203,562					
Less Surplus Cash in Hands of Trustees . . .	3,343	200,219	3·14	95–98	4	$4\frac{1}{16}$
		428,175				
Creditors		43,963	9·75	—	—	—
		384,212				
Preference Shareholders £10 shares	150,000					
Final Dividend . . .	1,969					
		151,969	2·53	$9\frac{1}{4}$–$9\frac{3}{4}$	5	$5\frac{1}{4}$
		232,243				
Ordinary Shareholders £1 shares		150,000	1·55	$1\frac{1}{2}$–$1\frac{3}{4}$	10	$6\frac{3}{16}$
		82,243				
Final Dividend . . .	7,875					
Unclaimed Dividends . .	222					
		8,097	—	—	—	—
		£74,146				

Basis of Valuation

We have been careful to state that the assets are given at their book value, and the student should not accept the figures given without inquiry. He must endeavour in all cases to obtain reference to some reasonably accurate basis, such as the valuation by a competent firm made, say, at the time the company was formed, or when the debentures were issued, in accordance with the suggestions given in Chapter V. In the case of the investment in 2½ per cent Consols, a clear warning is visible on the balance sheet. For it can be seen that their market value is now only £16,450, which is some £6,600 less than was paid for them.

Capital Safety and Rate of Income

Let the reader note the inverse proportion of the rates between capital safety and rate of income. Here is debenture stock, apparently secured beyond all immediate risk, yet it is quoted at a discount and would yield the investor only $4\frac{1}{16}$ per cent, while the £1 ordinary shares, with a safety margin of 11s. per share, stand at a premium of 12s. 6d. per share and yield a return of $6\frac{3}{16}$ per cent

on the outlay. It is obvious, therefore, that at $1\frac{5}{8}$ (£1 12s. 6d.) per share, a purchaser would be buying on the assumption that the realizable value of the assets is equal to the book value, and that a yield of $6\frac{3}{16}$ per cent will be maintained. In other words, he sets off the chance of a higher yield against the greater risk of loss of dividend and capital.

It is usually safe to assume that the higher the yield the greater the risk the capital runs. But it is not equally true that low yield coincides with capital stability.

For example, at the end of 1946, which probably marked the peak of Mr. Dalton's "cheap money drive," $2\frac{1}{2}$ per cent Consols stood at $98\frac{1}{2}$, giving a yield of about £2 10s. 10d.; and the Chancellor was able to issue his $2\frac{1}{2}$ per cent Treasury Bonds at 100, to give a yield of £2 10s. However, by the middle of 1952, a mere six and a half year later, $2\frac{1}{2}$ per cent Consols stood at 56 and $2\frac{1}{2}$ per cent Treasury stood at 54.

CHAPTER VII

THE AUDITORS' REPORT

THE investigator has already been advised to pay serious attention to the Auditors' Report, which must be *actually attached* to the balance sheet. Previous to the passing of the Companies Act, 1929, it was not necessary for the auditors' report to be so attached. With the passing of the Companies Act, 1948, the position of the auditor has been considerably strengthened. At the same time, the procedure of his appointment, his qualifications, and of his right to attend meetings, have been clearly defined, whilst the scope of his examination and report have been specifically extended to cover the published profit and loss account, in addition to the balance sheet.

Reference to Previous Report

Sometimes difficulties are suggested by reference to the Report of some past year, as in the balance sheet of a well-known firm for 31st January, 19... The reader is asked to note the reservation contained in the auditors' certificate.

"We have obtained all the information and explanations which to the best of our knowledge and belief were necessary for the purpose of our audit. In our opinion proper books of account have been kept by the company so far as appears from our examination of those books. We have examined the balance sheet as at 31st January, 19.., and the profit and loss account for the year ended 31st January, 19.., which are in agreement with the books of account. *Subject to our views previously expressed in our Report, dated 23rd March,* 19.., *on the balance sheet and profit and loss account for the year ended 31st January,* 19.., in our opinion, and to the best of our information, and according to the explanation given to us, the said accounts with the notes attached thereto give the information required by the Companies Act, 1948, in the manner so required, and the balance sheet gives a true and fair view of the state of the company's affairs as at 31st January, 19.., and the profit and loss account gives a true and fair view of the profit for the year ended on that date."

It is quite clear that the auditors intend to give the shareholder pause, but no effort is made to assist him by the repetition of a report given four years previously.

The ordinary man will certainly wonder how it happens that some auditors, who can scarcely avoid knowing the precise state of a company's affairs if they but exercised ordinary skill and their statutory rights, do not submit fuller reports in cases where the balance sheets literally bristle with unsatisfactory items.

Position of Auditor

Now the balance sheet is drawn up either by the company's staff or by the auditors at the request of the directors; and it is then submitted to the Board for adoption. But it frequently happens that when it is issued to the shareholders it is in a very different form from that in which it was first taken into the Board Room. Apart from technical points the reason is generally to be found in the delicate position which the auditor occupies. On the one side, there confronts him his conception of his duty to the members; on the other side, there is the necessity for meeting the views of the directors, which may honestly differ from his own. In many cases, no doubt, the auditor can fulfil both these demands upon him with honour to himself and benefit to his business, but it is not invariably so.

Duties of Auditor

As the auditor is generally altogether overlooked by the public until such time as he is altogether blamed, it may be well to set out here two important definitions of the duties and responsibilities of auditors, as conceived by two great legal intellects. In deciding a historic case, the *London and General Bank*, Lord Justice Lindley said—

Lindley, L.J., 1895, 2 Ch., 673

"It is no part of an auditor's duty to give advice, either to directors or shareholders, as to what they ought to do. An auditor has nothing to do with the prudence or imprudence of making loans with or without security. It is nothing to him whether the business of a company is conducted prudently or imprudently, profitably or unprofitably. It is nothing to him whether dividends are properly or improperly declared, provided he discharges his own duty to the shareholders. His business is to ascertain the true financial position of the company at the time of the audit, and his duty is confined to that. But then comes the question: How is he to ascertain that position? The answer is: By examining the books of the company. But he does not discharge his duty by doing this without inquiry, and without taking any trouble to see that the

books themselves show the company's true position. He must take reasonable care to ascertain that they do so. Unless he does this his audit will be worse than an idle farce. Assuming the books to be so kept in order as to show the true position of the company, the auditor has to frame a balance sheet showing that position according to the books, and to certify that the balance sheet is correct in that sense. . . . An auditor, however, is not bound to do more than exercise reasonable care and skill in making inquiries and investigations. He is not an insurer. . . . What is reasonable care in any particular case must depend upon the circumstances of that case. Where there is nothing to excite suspicion very little inquiry will be reasonably sufficient. . . . Where suspicion is aroused more care is obviously necessary."

It is clear that the auditor does not glean all the facts of the position for his private information. His examination is useless except it be for the purpose of preparing such a balance sheet for the members as will give them a true idea of the financial position. In the case referred to above, the auditor allowed himself to be dissuaded by the Board from mentioning in his certificate unsatisfactory assets. As a result the directors declared a dividend, which it was subsequently held should not have been paid and the auditor was declared liable, with the directors, to repay to the company the amount of the dividend. It is important to notice that Lord Justice Lindley further stated that it is not enough for the auditor to give the members of a company "means of obtaining information"; *they must be given the necessary information itself.*

Lopes, L.J., 1896, 2 Ch., 288, 289

Again, in the *Kingston Cotton Mills Co.* case Lord Justice Lopes gave the following definition—

"It is the duty of an auditor to bring to bear on the work he has to perform that skill, care, and caution which a reasonably competent, careful, and cautious auditor would use. What is reasonable skill, care, and caution must depend on the particular circumstances of each case. An auditor is not bound to be a detective, or, as was said, to approach his work with suspicion, or with a foregone conclusion that there is something wrong. He is a watchdog, not a bloodhound. He is justified in believing tried servants of the company in whom confidence is placed by the company. He is entitled to assume that they are honest and to rely upon their representations, provided he takes reasonable care. If there is anything calculated to excite suspicion, he should probe it to the bottom; but in the absence of anything of that kind, he is only

bound to be reasonably cautious and careful. . . . It is not the duty of an auditor to take stock; he is not a stock expert; there are many matters in which he must rely on the honesty and accuracy of others. He does not guarantee the discovery of all fraud."

Companies Act, 1948

The responsibilities which these and other decisions have laid upon auditors have since been definitely placed on the Statute Book, and their power to insist on information has consequently been increased. To begin with, Section 159 of the Companies Act, 1948, sets out clearly the conditions governing the appointment of the auditor, and the necessary procedure for fixing his remuneration. Section 160 lays down the special procedure to be followed if it is proposed to appoint as auditor anybody other than the person at present appointed. Section 161 lays down the qualifications he must possess and under what circumstances anyone shall be disqualified from appointment as auditor. Section 162 gives the auditor the right of access to all the books and vouchers of the company and the right to all such information and explanation as he thinks necessary. It also gives him the right to receive notice of all general meetings, and the right to attend those meetings and be heard at those meetings. Furthermore his report must be read at the meeting and be open for inspection by any member. Section 156 lays down that the auditors' report shall be attached to the balance sheet, and Section 158 requires the report and balance sheet to be sent to all members of the company.

The Ninth Schedule of the Act sets out those matters on which the auditors must specifically report. These include—

(1) Whether they have obtained all the information and explanations they required (As laid down by Section 162).

(2) Whether the company has kept proper books of account so as to give a true and fair view of the state of the company's affairs and to explain its transactions. (As laid down by Section 147).

(3) Whether the balance sheet and profit and loss account are in agreement with the books of the company; whether the accounts give all the information required by the Act; whether the balance sheet gives a true and fair view of the state of the company's affairs at the end of its financial year; whether the profit and loss account gives a true and fair view of the profit or loss for its financial year (as laid down in Sections 148, 149 and the Eighth Schedule of the Act).

(4) In the case of a holding company, whether the group

accounts have been properly prepared so as to give a true and fair view of the state of affairs and profit and loss of the company and its subsidiaries (as laid down in Sections 150 to 154).

Auditor Servant of Members

The auditor is therefore placed in a position of power which he is expected to use in the interests of the members. If, in the course of his duties, he acquires facts which, in his opinion, are vital to the formation of a correct judgment of the company's position, he must either insist on those facts being stated in the balance sheet or give them to the shareholders himself in his report. If the directors oppose both means of publicity, a high-minded auditor has but one course; he must resign. By adopting this course the matter will almost certainly be forced into publicity, and the attention of the members will be directed to the cause of the dispute. Such resignations on questions of principle are not unknown, and the auditors have as their reward the respect and appreciation of honest minds. But cases have not been unknown in the past where the auditor might be thought to have taken too narrow a view of his duty. The instance already cited illustrates this point. In the disastrous ends of Measures Brothers and of the Law Guarantee Trust and Accident Society we have examples of calamities, the approach of which might have been conveyed to the shareholders if the auditors had taken a wider view of their duties than they appear to have done. We admit to the full the difficult position in which the conscientious auditor is placed, but if he will recognize that his salvation and the honourable future of his profession lie in the true expression of his judgment, not only to the Board of Directors, but to the members, he will undoubtedly win the unreserved approbation of all who desire a higher standard of duty in these matters.

APPENDIX I

PRO FORMA BALANCE SHEET

SHOWING ITEMS WHICH MUST BE DEALT WITH IN ACCORDANCE WITH THE RELATIVE SECTIONS OF THE COMPANIES ACT, 1948

PRO FORMA

SHOWING ITEMS WHICH MUST BE
THE RELEVANT SECTIONS AND SCHEDULES

Corresponding figures for last year, Sched. VIII, Para. 11 (11)	*Capital and Liabilities*	Sched. VIII, Para. 2
	Capital Authorized **Capital Issued—**	Sect. 58, Para. 3 Sched. VIII, Para. 2
	(a) Redeemable Preference Shares to be redeemed on or before .....(date).....	Sect. 58 Sched. VIII, Para. 2 (*a*)
	(b) Capital on which interest has been paid out of capital	Sect. 65 Sched. VIII, Para. 2 (*b*)
	Capital Redemption Reserve Fund	Sect. 58, Para. 1 (*d*)
	Share Premium Account	Sect. 56 Sched. VIII, Para. 2 (*c*)
	Capital Reserves	Sched. VIII, Para. 4 Sched. VIII, Para. 6 Sched. VIII, Para. 25 (1) (*a*) Sched. VIII, Para. 27 (1) (*b*) (*c*)
	(a) Source of any increase (b) Application of any decrease	Sched. VIII, Para. 7 Sched. VIII, Para. 20 Sched. VIII, Para. 23 (1) (*a*) Sched. VIII, Para. 24 (1) Sched. VIII, Para. 25 (1) (*a*)
	Revenue Reserves—	Sched. VIII, Para. 4 Sched. VIII, Para. 6 Sched. VIII, Para. 25 (1) (*a*) Sched. VIII, Para. 27 (1) (*b*) (*c*) Sched. VIII, Para. 27 (2)
	(*a*) Source of any increase (*b*) Application of any decrease	Sched. VIII, Para. 7 Sched. VIII, Para. 23 (1) (*a*) Sched. VIII, Para. 24 (1) Sched. VIII, Para. 25 (1) (*a*)
	(*c*) Reserve for future taxation	Sched. VIII, Para. 11 (10)
	Debentures—	
	(*a*) Of which ...... have been redeemed and can be reissued	Sect. 90 Sched. VIII, Para. 2 (*d*)
	(*b*) Of which ...... are held by a nominee or trustee for the company	Sched. VIII, Para. 10
	(*c*) Of which ...... are held by holding company or fellow subsidiary	Sched. VIII, Para. 16
	Mortgages and Secured Loans	Sched. VIII, Para. 9
	Provisions—	Sched. VIII, Para. 4 Sched. VIII, Para. 6 Sched. VIII, Para. 7 Sched. VIII, Para. 23 (1) (*a*) Sched. VIII, Para. 24 (1) Sched. VIII, Para. 25 (1) (*a*) Sched. VIII, Para. 27 (1) (*a*) Sched. VIII, Para. 27 (2)
	Current Liabilities—	Sched. VIII, Para. 4 Sched. VIII, Para. 27 (1) Sched. VIII, Para. 27 (2)
	(*a*) Bank Loan and Overdrafts	Sched. VIII, Para. 8 (1) (*d*) Sched. VIII, Para. 23 (1) (*a*) Sched. VIII, Para. 24 (1)
	(*b*) Current U.K. Taxation	Sched. VIII, Para. 11 (10) Sched. VIII, Para. 24 (1)
	(*c*) Loans from and other indebtedness to subsidiaries	Sched. VIII, Para. 15 (2) Sched. VIII, Para. 21 (*a*)
	(*d*) Debts to holding company or fellow subsidiaries	Sched. VIII, Para. 16
	(*e*) Recommended dividends	Sched. VIII, Para. 8 (1) (*e*)
	Separate Notes (if not otherwise shown) **of—**	
	(*a*) Outstanding options to acquire shares of the company	Sched. VIII, Para. 11 (2)
	(*b*) Arrears of fixed cumulative dividend	Sched. VIII, Para. 11 (3)
	(*c*) Charges on assets to secure liabilities of other persons	Sched. VIII, Para. 11 (4) Sched. VIII, Para. 24 (1)
	(*d*) Contingent liabilities	Sched. VIII, Para. 11 (5) Sched. VIII, Para. 24 (1)
	(*e*) Contracts for Capital Expenditure	Sched. VIII, Para. 11 (6) Sched. VIII, Para. 24 (1)
	(*f*) Basis of converting foreign currency	Sched. VIII, Para. 11 (9)
	(*g*) Details of company's own shares or debentures held by subsidiaries	Sched. VIII, Para. 15 (3) Sched. VIII, Para. 21 (*a*)

Signed by two Directors—	Sect. 155
Directors' Report attached—	Sects. 157 and 163

BALANCE SHEET

DEALT WITH IN ACCORDANCE WITH OF THE COMPANIES ACT, 1948

Sects. 127–129
Sects. 147–158
Sects. 162–163
Sect. 410
Sect. 435
Sect. 455

Corresponding figures for last year		
	Assets	Sched. VIII, Para. 2
	Fixed Assets—	Sched. VIII, Para. 4
Sched. VIII, Para. 11 (11)	(a) At Cost, or valuation (b) *Less* Depreciation to date	Sched. VIII, Para. 5 Sched. VIII, Para. 6 Sched. VIII, Para. 13 (1) (*a*) Sched. VIII, Para. 24 (1) Sched. VIII, Para. 25 (1) (*a*) Sched. VIII, Para. 27 (2)
	Investments	Sched. VIII, Para. 5 Sched. VIII, Para. 5 (2) (*c*) Sched. VIII, Para. 25 (1) (*a*)
	(a) Trade Investments	Sched. VIII, Para. 8 (1) (*a*) Sched. VIII, Para. 24 (1)
	(b) Quoted Investments (other than (a)) of which (i) granted permission to deal on a recognized Stock Exchange (ii) not granted permission to deal	Sched. VIII, Para. 8 (1) (*a*) Sched. VIII, Para. 8 (3) Sched. VIII, Para. 24 (1) Sched. VIII, Para. 28
	Note: Market Value of Quoted Investments	Sched. VIII, Para. 5 (2) (*c*) Sched. VIII, Para. 11 (8) Sched. VIII, Para. 23 (1) (*a*) Sched. VIII, Para. 24 (1)
	(c) Unquoted Investments (other than (a))	Sched. VIII, Para. 8 (1) (*a*) Sched. VIII, Para. 24 (1) Sched. VIII, Para. 28
	(*d*) Shares in Subsidiary Companies	Sched. VIII, Para. 15 (2) Sched. VIII, Para. 21 (*a*)
	Goodwill, Patents and Trade Marks	Sched. VIII, Para. 5 (2) (*d*) Sched. VIII, Para. 8 (1) (*b*) Sched. VIII, Para. 8 (2) Sched. VIII, Para. 25 (1) (*a*)
	Current Assets—	Sched. VIII, Para. 4 (1) and (2)
	(*a*) Fact that any current assets have realizable value less than that stated	Sched. VIII, Para. 11 (7) Sched. VIII, Para. 24 (1)
	(*b*) Debts due from subsidiaries	Sched. VIII, Para. 15 (2) Sched. VIII, Para. 21 (*a*)
	(*c*) Debts due from holding company or fellow subsidiaries	Sched. VIII, Para. 16
	Loans—	
	(*a*) For purchase of company's shares by trustee for employees, or by employees	Sect. 54 (1) (*b*) and (*c*) Sched. VIII, Para. 8 (1) (*c*)
	(*b*) Loans to directors or officers of the company	Sect. 190 Sect. 197
	(*c*) Loans to subsidiaries	Sched. VIII, Para. 15 (2) Sched. VIII, Para. 20 (*a*)
	(*d*) Loans to holding company or fellow subsidiaries (*e*) Debentures of holding company or of fellow subsidiaries	Sched. VIII, Para. 16
	Preliminary and other Expenses— (*a*) Preliminary Expenses (*b*) Expenses of issuing shares or debentures (*c*) Commission on shares or debentures (*d*) Discount on debentures (*e*) Discount on shares	Sect. 56 Sect. 57 Sched. VIII, Para. 3
	Where no Group Accounts are presented Separate Notes (if not otherwise shown) **of—**	Sects. 150–154
	(*a*) Reason why no group accounts are presented	Sched. VIII, Para. 15 (4) (*a*) Sched. VIII, Para. 21 (*b*)
	(*b*) Net profits and losses of subsidiaries not dealt with in holding company's accounts	Sched. VIII, Para. 15 (4) (*b*) Sched. VIII, Para. 21 (*b*)
	(*c*) Net profits and losses of subsidiaries that have been dealt with in holding company's accounts	Sched. VIII, Para. 15 (4) (*c*) Sched. VIII, Para. 21 (*b*)
	(*d*) Any qualifications on auditor's reports on subsidiaries' accounts	Sched. VIII, Para. 15 (4) (*d*) Sched. VIII, Para. 21 (*b*)
	(*e*) If necessary, a statement that the information required, at (*a*), (*b*), (*c*) and (*d*) above, is not available	Sched. VIII, Para. 15 (4) Sched. VIII, Para. 21 (*b*)
	(*f*) Pre-acquisition profits are not to be included under headings (*a*) to (*c*) above	Sched. VIII, Para. 15 (5)
	(*g*) Details of subsidiaries financial years where these do not coincide with that of holding company	Sect. 153 Sched. VIII, Para. 15 (6) Sched. VIII, Para. 22

Auditors' Report — Sect. 156
Sect. 162
Sched. IX
Sect. 163

APPENDIX II

PRO FORMA PROFIT AND LOSS ACCOUNT

Showing Items which must be dealt with in Accordance with the Relative Sections of the Companies Act, 1948

PRO FORMA PROFIT

SHOWING ITEMS WHICH MUST BE THE RELEVANT SECTIONS AND SCHEDULES

Corresponding figures for last year, Sched. VIII, Para. 14 (3)	**Directors' Emoluments,** Pensions, and Compensation for Loss of Office	Sect. 189 Sect. 191 Sects. 192–194 Sect. 196 Sect. 198 Sched. VIII, Para. 19
	Depreciation, etc., of Fixed Assets	Sched. VIII, Para. 12 (1) (*a*) Sched. VIII, Para. 23 (1) (*b*) Sched. VIII, Para. 24 (1) Sched. VIII, Para. 25 (1) (*b*) Sched. VIII, Para. 27 (2)
	Interest on Debentures and Fixed Loans	Sched. VIII, Para. 12 (1) (*b*) Sched. VIII, Para. 23 (1) (*b*) Sched. VIII, Para. 24 (1)
	U.K. Income and Profit Taxes	Sched. VIII, Para. 12 (1) (*c*) Sched. VIII, Para. 14 (3) Sched. VIII, Para. 23 (1) (*b*) Sched. VIII, Para. 24 (1)
	Provisions for Share Capital or Loan Redemption	Sched. VIII, Para. 12 (1) (*d*) Sched. VIII, Para. 23 (1) (*b*) Sched. VIII, Para. 24 (1)
	Amounts put to Reserves	Sched. VIII, Para. 12 (1) (*e*) Sched. VIII, Para. 23 (1) (*b*) Sched. VIII, Para. 24 (1) Sched. VIII, Para. 25 (1) (*b*) Sched. VIII, Para. 27 (1) (*b*) Sched. VIII, Para. 27 (2)
	Provisions (other than for Depreciation, etc., of Fixed Assets, shown above)	Sched. VIII, Para. 7 Sched. VIII, Para. 12 (1) (*f*) Sched. VIII, Para. 12 (2) Sched. VIII, Para. 23 (1) Sched. VIII, Para. 24 (1) Sched. VIII, Para. 25 (1) (*b*) Sched. VIII, Para. 27 (1) (*b*) Sched. VIII, Para. 27 (2)
	Dividends Paid and Proposed	Sched. VIII, Para. 12 (1) (*h*)
	Auditors' Remuneration	Sect. 159 Sched. VIII, Para. 13

AND LOSS ACCOUNT

DEALT WITH IN ACCORDANCE WITH OF THE COMPANIES ACT, 1948

Sects. 127–129
Sects. 147–158
Sects. 162–163
Sect. 410
Sect. 435
Sect. 455

Corresponding figures for last year, Sched. VIII, Para. 14 (5)	**Withdrawals from Reserves**	Sched. VIII, Para. 12 (1) (e) Sched. VIII, Para. 23 (1) (b) Sched. VIII, Para. 24 (1) Sched. VIII, Para. 25 (1) (b) Sched. VIII, Para. 27 (1) (b) Sched. VIII, Para. 27 (2)
	Withdrawals from Provisions (other than from Provisions for Depreciation, etc., of Fixed Assets) .	Sched. VIII, Para. 7 Sched. VIII, Para. 12 (1) (f) Sched. VIII, Para. 12 (2) Sched. VIII, Para. 23 (1) Sched. VIII, Para. 24 (1) Sched. VIII, Para. 25 (1) (b) Sched. VIII, Para. 27 (1) (b) Sched. VIII, Para. 27 (2)
	Income from— (a) Trade Investments . . . . (b) Other Investments	Sched. VIII, Para. 12 (1) (g) Sched. VIII, Para. 23 (1) Sched. VIII, Para. 24 (1)
	Separate Notes (if not otherwise shown) **of—**	
	(a) Any interest on shares which has been paid out of capital	Sched. VIII, Para. 2 (b)
	(b) Whether, and how, depreciation is provided, if a normal charge is not made.	Sched. VIII, Para. 14 (2)
	(c) Basis of computing U.K. income and profits taxes	Sched. VIII, Para. 14 (3)
	(d) Whether dividends are subject to deduction of income tax	Sched. VIII, Para. 14 (4)
	(e) Transactions of an exceptional or non-recurrent nature	Sched. VIII, Para. 14 (6) (a)
	(f) Effect of any change in the basis of accounting .	Sched. VIII, Para. 14 (6) (b)
	Auditors' Report—	Sect. 156 Sect. 162 Sched. IX Sect. 163

APPENDIX III

COMPANIES ACT, 1948

PRINCIPAL SECTIONS REFERRING TO ACCOUNTS AND AUDIT

APPENDIX III

COMPANIES ACT, 1948

PRINCIPAL SECTIONS REFERRING TO ACCOUNTS AND AUDIT

INCORPORATION OF COMPANIES AND MATTERS INCIDENTAL THERETO

Memorandum of Association—Mode of Forming Company

Sect 1.—(1) Any seven or more persons, or, where the company to be formed will be a private company, any two or more persons, associated for any lawful purpose may, by subscribing their names to a memorandum of association and otherwise complying with the requirements of this Act in respect of registration, form an incorporated company, with or without limited liability.

(2) *Such a company may be either—*

(*a*) a company having the liability of its members limited by the memorandum to the amount, if any, unpaid on the shares respectively held by them (in this Act termed "*a company limited by shares*"); or

(*b*) a company having the liability of its members limited by the memorandum to such amount as the members may respectively thereby undertake to contribute to the assets of the company in the event of its being wound up (in this Act termed "*a company limited by guarantee*"); or

(*c*) a company not having any limit on the liability of its members (in this Act termed "*an unlimited company*").

Articles of Association—Prescribing Regulations for Companies

Sect. 6. There may in the case of a company limited by shares, and there shall in the case of a company limited by guarantee or unlimited, be registered with the memorandum articles of association signed by the subscribers to the memorandum and prescribing regulations for the company.

Sect. 8.—(1) *Articles of association may adopt all or any of the regulations contained in Table A* [some of the sections of which are shown below].

(2) In the case of a company limited by shares and registered after the commencement of this Act, if articles are not registered, or, if articles are registered, in so far as the articles do not exclude or modify the regulations contained in Table A, those regulations shall, so far as applicable, be the regulations of the company in the same manner and to the same extent as if they were contained in duly registered articles. [*But see Sect.* 454.]

FIRST SCHEDULE

TABLE A

The following sections deal, in particular, with regulations concerning accounts—

Dividends and Reserve

Para. 114. *The company in general meeting may declare dividends,* but no dividend shall exceed the amount recommended by the directors.

Para. 115. *The directors may from time to time pay* to the members such *interim dividends* as appear to the directors to be justified by the profits of the company.

Para. 116. *No dividend shall be paid otherwise than out of profits.*

Para. 117. *The directors may,* before recommending any dividend, *set aside* out of the profits of the company *such sums as they think proper as a reserve* or reserves which shall, at the discretion of the directors, be applicable for any purpose to which the profits of the company may be properly applied, and pending such application may, at the like discretion, either be employed in the business of the company or be invested in such investments (other than shares of the company) as the directors may from time to time think fit. *The directors may also* without placing the same to reserve *carry forward any profits which they may think prudent not to divide.*

Accounts

Para. 123. *The directors shall cause proper books of account to be kept* with respect to—

(*a*) all sums of money received and expended by the company and the matters in respect of which the receipt and expenditure takes place;

(*b*) all sales and purchases of goods by the company; and

(*c*) the assets and liabilities of the company.

Proper books shall not be deemed to be kept if there are not kept such books of account as are necessary to give a true and fair view of the state of the company's affairs and to explain its transactions.

Para. 124. *The books of account shall be kept at the registered office of the company,* or, subject to section 147 (3) of the Act, at such other place or places as the directors think fit, and shall always be open to the inspection of the directors.

Para. 125. *The directors shall* from time to time *determine whether* and to what extent and at what times and places and under what conditions or regulations *the accounts and books* of the company or any of them *shall be open to the inspection of members* not being directors, and no member (not being a director) shall have any right of inspecting any account or book or document of the company except as conferred by statute or authorized by the directors or by the company in general meeting.

Para. 126. *The directors shall* from time to time, in accordance with sections 148, 150 and 157 of the Act, *cause to be prepared* and to be laid before the company in general meeting such *profit and loss accounts, balance sheets, group accounts* (*if any*) *and reports* as are referred to in those sections.

Para. 127. *A copy of every balance sheet* (*including every document required by law to be annexed thereto*) which is to be laid before the company in general meeting, *together with a copy of the auditors' report, shall* not less than twenty-one days before the date of the meeting *be sent to every member* of, and every holder of debentures of, the company and to every person registered under regulation 31. Provided that this regulation shall not require a copy of those documents to be sent to any person of whose address the company is not aware or to more than one of the joint holders of any shares or debentures.

Capitalization of Profits

Para. 128. *The company* in general meeting *may* upon the recommendation of the directors *resolve* that it is desirable *to capitalize any part of* the amount for the time being standing to the credit of any of *the company's reserve accounts or* to the credit of the *profit and loss account* or otherwise available for distribution, and accordingly that such sum be set free for distribution amongst the members who

would have been entitled thereto if distributed by way of dividend and in the same proportions on condition that the same be not paid in cash but be applied either in or towards paying up any amounts for the time being unpaid on any shares held by such members respectively or paying up in full unissued shares or debentures of the company to be allotted and distributed credited as fully paid up to and amongst such members in the proportion aforesaid, or partly in the one way and partly in the other, and the directors shall give effect to such resolution:

Provided that a share premium account and a capital redemption reserve fund may, for the purposes of this regulation, only be applied in the paying up of unissued shares to be issued to members of the company as fully-paid bonus shares.

Audit

Para. 130. *Auditors shall be appointed* and their duties regulated in accordance with sections 159 to 162 of the Act.

MEANING OF "PRIVATE COMPANY"

Sect. 28.—(1) For the purposes of this Act, *the expression "private company" means a company which by its articles*—

(*a*) *restricts the right to transfer its shares*; and

(*b*) *limits the number of its members to fifty*, not including persons who are in the employment of the company and persons who, having been formerly in the employment of the company, were while in that employment, and have continued after the determination of that employment to be, members of the company; and

(*c*) *prohibits any invitation to the public to subscribe for any shares* or debentures of the company.

(2) Where two or more persons hold one or more shares in a company jointly, they shall, for the purposes of this section, be treated as a single member.

PROHIBITION OF FINANCIAL ASSISTANCE BY COMPANY FOR PURCHASE OF ITS OWN SHARES

Sect. 54.—(1) Subject as provided in this section, *it shall not be lawful for a company to give*, whether directly or indirectly, and whether by means of a loan, guarantee, the provision of security or otherwise, *any financial assistance for the* purpose of or in connection with a *purchase or subscription* made or to be made by any person *of or for any shares in the company, or,* where the company is a subsidiary company, *in its holding company;*

Provided that *nothing* in this section *shall be taken to prohibit*—

(*a*) *where the lending of money is part of the ordinary business of a company,* the lending of money by the company in the ordinary course of its business;

(*b*) the provision by a company, in accordance with any scheme for the time being in force, of money for the purchase of, or subscription for, fully-paid shares in the company or its holding company, being *a purchase or subscription by trustees of or for shares to be held by or for the benefit of employees of the company,* including any director holding a salaried employment or office in the company;

(*c*) the making by a company of *loans to persons,* other than directors, bona fide in the employment of the company with a view to *enabling those*

persons to purchase or subscribe for fully-paid shares in the company or its holding company *to be held by themselves by way of beneficial ownership.*

(2) [*Here follows a penalty clause for failure to comply.*]

ISSUE OF SHARES AT PREMIUM AND DISCOUNT AND REDEEMABLE PREFERENCE SHARES

Application of Premiums Received on Issue of Shares

Sect. 56.—(1) *Where a company issues shares at a premium,* whether for cash or otherwise, *a sum equal to the aggregate amount* or value *of the premiums* on those shares *shall be transferred to an account, to be called "the share premium account,"* and the provisions of this Act relating to the reduction of the share capital of a company shall, except as provided in this section, apply as if the share premium account were paid up share capital of the company.

(2) *The share premium account may,* notwithstanding anything in the foregoing subsection, *be applied* by the company *in paying up unissued shares* of the company *to be issued* to members of the company as fully-paid bonus shares, *in writing off*—

(*a*) the *preliminary expenses* of the company; or

(*b*) the *expenses* of, or the *commission* paid or *discount* allowed *on, any issue of shares or debentures* of the company;

or in providing for the premium payable on redemption of *any redeemable preference shares or* of any *debentures* of the company.

(3) Where a company has before the commencement of this Act issued any shares at a premium, this section shall apply as if the shares had been issued after the commencement of this Act:

Provided that any part of the premiums which has been so applied that it does not at the commencement of this Act form an identifiable part of the company's reserves within the meaning of the Eighth Schedule to this Act [*reproduced* in extenso *after Sect.* 459 *of the Act*] shall be disregarded in determining the sum to be included in the share premium account.

Power to Issue Shares at a Discount

Sect. 57.—(1) Subject as provided in this section, *it shall be lawful for a company to issue at a discount shares in the company of a class already issued*:

Provided that—

(*a*) *the issue* of the shares at a discount *must be authorized* by resolution passed *in general meeting* of the company, and *must be sanctioned by the court*;

(*b*) *the resolution must specify the maximum rate of discount* at which the shares are to be issued;

(*c*) *not less than one year must* at the date of the issue *have elapsed since the date on which the company was entitled to commence business*;

(*d*) *the shares* to be issued at a discount *must be issued within one month after* the date on which *the issue is sanctioned by the court* or within such extended time as the court may allow.

(2) Where a company has passed a resolution authorizing the issue of shares at a discount, it may apply to the court for an order sanctioning the issue, and on any such application the court, if, having regard to all the

circumstances of the case, it thinks proper so to do, may make an order sanctioning the issue on such terms and conditions as it thinks fit.

(3) Every prospectus relating to the issue of the shares must contain particulars of the discount allowed on the issue of the shares or of so much of that discount as has not been written off at the date of the issue of the prospectus.

[*Here follows a penalty clause for failure to comply.*]

POWER TO ISSUE REDEEMABLE PREFERENCE SHARES

Sect. 58.—(1) Subject to the provisions of this section, *a company* limited by shares *may*, if so authorized by its articles *issue preference shares which are*, or at the option of the company are to be liable, *to be redeemed*:

Provided that—

(*a*) *no such shares shall be redeemed except out of profits* of the company which would otherwise be available for dividend *or out of the proceeds of a fresh issue* of *shares made for the purposes of the redemption*;

(*b*) no such shares shall be redeemed unless *they are fully paid*;

(*c*) *the premium*, if any, *payable on redemption, must have been provided for out of the profits* of the company *or out of the company's share premium account* before the shares are redeemed;

(*d*) *where* any such *shares are redeemed otherwise than out of the proceeds of a fresh issue, there shall out of profits* which would otherwise have been available for dividend *be transferred to a reserve fund*, to be called "the capital redemption reserve fund," *a sum equal to the nominal amount of the shares redeemed*, and the provisions of this Act relating to the reduction of the share capital of a company shall, except as provided in this section, apply as if the capital redemption reserve fund were paid-up share capital of the company.

(2) Subject to the provisions of this section, the redemption of preference shares thereunder may be effected on such terms and in such manner as may be provided by the articles of the company.

(3) The redemption of preference shares under this section by a company shall not be taken as reducing the amount of the company's authorized share capital.

(4) Where in pursuance of this section a company has redeemed or is about to redeem any preference shares, it shall have power to issue shares up to the nominal amount of the shares redeemed or to be redeemed as if those shares had never been issued, and accordingly the share capital of the company shall not for the purposes of any enactments relating to stamp duty be deemed to be increased by the issue of shares in pursuance of this subsection:

Provided that, where new shares are issued before the redemption of the old shares, the new shares shall not, so far as relates to stamp duty, be deemed to have been issued in pursuance of this subsection unless the old shares are redeemed within one month after the issue of the new shares.

(5) *The capital redemption reserve fund may*, notwithstanding anything in this section, *be applied* by the company *in paying up unissued shares of the company to be issued to members of the company as fully-paid bonus shares.*

POWER OF COMPANY TO PAY INTEREST OUT OF CAPITAL IN CERTAIN CASES

Sect. 65.—(1) *Where any shares* of a company *are issued* for the purpose of raising money *to defray the expenses of the construction of any works* or buildings or the provision of any plant *which cannot be made profitable for a lengthened period, the company may pay interest* on so much of that share capital as is for the time being paid up for the period and subject to the conditions and restrictions in this section mentioned, *and may charge the sum so paid by way of interest to capital as part of the cost of construction of the work* or building, or the provision of plant:

Provided that—

(*a*) no such payment shall be made unless *it is authorized by the articles or by special resolution*;

(*b*) no such payment, whether authorized by the articles or by special resolution, shall be made without the *previous sanction of the Board of Trade*;

(*c*) before sanctioning any such payment the Board of Trade may, at the expense of the company, appoint a person to inquire and report to them as to the circumstances of the case, and may, before making the appointment, require the company to give security for the payment of the costs of the inquiry;

(*d*) the payment shall be made only for such period as may be determined by the Board of Trade, and that *period shall in no case extend beyond the close of the half year next after the half year during which the works or buildings have been actually completed* or the plant provided;

(*e*) the rate of interest shall in no case exceed four per cent per annum or *such* other *rate as may for the time being be prescribed by order of the Treasury*;

(*f*) the payment of the interest shall not operate as a reduction of the amount paid up on the shares in respect of which it is paid;

(*g*) nothing in this section shall affect any company to which the Indian Railways Act, 1894, as amended by any subsequent enactment, applies.

(2) The power conferred by this section on the Treasury shall be exercisable by statutory instrument which shall be subject to annulment in pursuance of a resolution of either House of Parliament.

POWER TO REISSUE REDEEMED DEBENTURES IN CERTAIN CASES

Sect. 90.—(1) Where either before or after the commencement of this Act a company has redeemed any debentures previously issued, then—

(*a*) *unless any provision to the contrary*, whether express or implied, *is contained in the articles or in any contract* entered into by the company; or

(*b*) *unless the company has*, by passing a resolution to that effect or by some other act, *manifested its intention that the debentures shall be cancelled*;

the company shall have, and shall be deemed always to have had, *power to reissue the debentures*, either by reissuing the same debentures or by issuing other debentures in their place.

(2) Subject to the provisions of the next following section, on a reissue

of redeemed debentures the person entitled to the debentures shall have, and shall be deemed always to have had, the same priorities as if the debentures had never been redeemed.

(3) Where a company has either before or after the commencement of this Act deposited any of its debentures to secure advances from time to time on current account or otherwise, the debentures shall not be deemed to have been redeemed by reason only of the account of the company having ceased to be in debit whilst the debentures remained so deposited.

(4) The reissue of a debenture or the issue of another debenture in its place under the power by this section given to, or deemed to have been possessed by, a company, whether the reissue or issue was made before or after the commencement of this Act, shall be treated as the issue of a new debenture for the purposes of stamp duty, but it shall not be so treated for the purposes of any provision limiting the amount or number of debentures to be issued:

Provided that any person lending money on the security of a debenture reissued under this section which appears to be duly stamped may give the debenture in evidence in any proceedings for enforcing his security without payment of the stamp duty or any penalty in respect thereof, unless he had notice or, but for his negligence, might have discovered, that the debenture was not duly stamped, but in any such case the company shall be liable to pay the proper stamp duty and penalty.

ANNUAL RETURN

Annual Return to be Made by Company having a Share Capital

Sect. 124.—(1) *Every company* having a share capital *shall, once at least in every year, make a return containing* with respect to the registered office of the company, registers of members and debenture holders, shares and debentures, indebtedness, past and present members and directors and secretary, *the matters specified in* Part I of *the Sixth Schedule* to this Act [*some of the sections of which are shown on pp.* 89–90].

Documents to be Annexed to Annual Return

Sect. 127.—(1) Subject to the provisions of this Act, *there shall be annexed to the annual return*—

(*a*) a written copy, certified both by a director and by the secretary of the company to be *a true copy, of every balance sheet* laid before the company in general meeting during the period to which the return relates (*including every document required by law to be annexed to the balance sheet*); and

(*b*) *a copy*, certified as aforesaid, *of the report of the auditors* on, *and of the report of the directors accompanying, each such balance sheet*;

and where any such balance sheet or document required by law to be annexed thereto is in a foreign language, there shall be annexed to that balance sheet a translation in English of the balance sheet or document certified in the prescribed manner to be a correct translation.

(2) If any such balance sheet as aforesaid or document required by law to be annexed thereto did not comply with the requirements of the law as

in force at the date of the audit with respect to the form of balance sheets or documents aforesaid, as the case may be, there shall be made such additions to and corrections in the copy as would have been required to be made in the balance sheet or document in order to make it comply with the said requirements, and the fact that the copy has been so amended shall be stated thereon.

(3) [*Here follows a penalty clause for failure to comply.*]

(4) This section shall not apply to an assurance company which has complied with the provisions of subsection (4) of section seven of the Assurance Companies Act, 1909.

CERTIFICATES TO BE SENT BY PRIVATE COMPANY WITH ANNUAL RETURN

Sect. 128. *A private company shall send* with the annual return required by section one hundred and twenty-four of this Act *a certificate* signed both by a director and by the secretary of the company *that the company has not, since the date of the last return*, or, in the case of a first return, since the date of the incorporation of the company, *issued any invitation to the public to subscribe for any shares or debentures of the company*, and, where the annual return discloses the fact that the number of members of the company exceeds fifty, also a certificate so signed that the excess consists wholly of persons who under paragraph (*b*) of subsection (1) of section twenty-eight of this Act are not to be included in reckoning the number of fifty.

EXEMPTION, IN CERTAIN CASES, OF PRIVATE COMPANIES, FROM REQUIREMENTS OF SECT. 127

Sect. 129.—(1) *A private company shall be excepted from* the requirements imposed by section one hundred and twenty-seven of this Act [i.e. of *filing a copy of the accounts with the Annual Return*] if, but only *if*,—

(*a*) *the conditions mentioned in the next following subsection are satisfied* at the date of the return and have been satisfied at all times since the commencement of this Act; and

(*b*) *there is sent with the return a certificate*, signed by the persons signing the certificates required to be so sent by the last foregoing section, *that* to the best of their knowledge and belief *the said conditions are and have been satisfied as aforesaid*:

Provided that if at any time it is shown that the said conditions are then satisfied in the case of any private company, the Board of Trade may on the application of the company's directors direct that, in relation to any subsequent annual returns of the company, it shall not be necessary for the said conditions to have been satisfied before that time, and the certificates sent with those returns shall in that event relate only to the period since that time.

(2) *The said conditions are*—

(*a*) *that the conditions contained in the Seventh Schedule* [not reproduced here] *to this Act are satisfied* as to the persons interested in the company's shares and debentures; and

(*b*) *that the number of persons holding debentures* of the company *is not more than fifty* (joint holders being treated as a single person); and

(c) *that no body corporate is a director* of the company *and neither the company nor any of the directors is party or privy to any arrangement whereby the policy of the company is capable of being determined by persons other than the directors, members and debenture holders or trustees for debenture holders.*

(3) A prosecution shall not be instituted in England in respect of any failure of a private company to comply with section one hundred and twenty-seven of this Act except by or with the consent of the Board of Trade.

(4) *Any reference in this Act to an exempt private company shall be construed as referring to a company with respect to which the conditions mentioned in subsection* (2) *of this section are satisfied* and have been satisfied at all times since the commencement of this Act or since the giving by the Board of Trade of a direction under the proviso to subsection (1) of this section.

(5) References in this section to the said conditions having been satisfied since the commencement of this Act shall, in relation to a company first registered after the commencement of this Act, be construed as referring to the conditions having been satisfied since the company's registration.

SIXTH SCHEDULE

CONTENTS AND FORM OF ANNUAL RETURN OF A COMPANY HAVING A SHARE CAPITAL

The following regulations concern certified copies of accounts.

Except where the company is either *an exempt private company* as defined by section 129 (4) of the Companies Act, 1948, which sends with this return a certificate in the form set out below or an assurance company which has complied with the provisions of section 7 (4) of the Assurance Companies Act, 1909, *there must be annexed to this return* a written copy, certified both by a director and by the secretary of the company to be *a true copy, of every balance sheet* laid before the company in general meeting during the period to which this return relates (*including every document required by law to be annexed to the balance sheet*) *and a copy* (certified as aforesaid) *of the report of the auditors* on, *and of the report of the directors* accompanying, each such balance sheet. If any such balance sheet or document required by law to be annexed thereto is in a foreign language there must also be annexed to that balance sheet a translation in English of the balance sheet or document certified in the prescribed manner to be a correct translation. If any such balance sheet as aforesaid or document required by law to be annexed thereto did not comply with the requirements of the law as in force at the date of the audit with respect to the form of balance sheets or documents aforesaid, as the case may be, there must be made such additions to and corrections in the copy as would have been required to be made in the balance sheet or document in order to make it comply with the said requirements, and the fact that the copy has been so amended must be stated thereon.

Additional Certificate to be given in the case of an Exempt Private Company by the Persons signing the above-mentioned Certificates.

We certify that, to the best of our knowledge and belief, the conditions mentioned in subsection (2) of section one hundred and twenty-nine of the Companies Act, 1948, are satisfied at the date of this return and have been satisfied at all times since . ...

Signed . Director
Signed.. ... . Secretary

* Insert "1st July, 1948" (the date of the commencement of the Companies Act, 1948) or, if the company was registered after that date, the date on which it was registered, or, if the proviso to s. 129 (1) of the Companies Act, 1948, has effect in relation to the return, the time at which it was shown to the Board of Trade that the conditions mentioned in the certificate were satisfied.

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Banking Companies

A banking company, in order to avail itself of the benefit of s. 432 of the Companies Act, 1948, must add to this return a statement of the names of the several places where it carries on business.

STATUTORY MEETING AND STATUTORY REPORT

Sect. 130.—(1) *Every company* limited by shares and every company limited by guarantee and having a share capital *shall, within a period of not less than one month nor more than three months from the date at which the company is entitled to commence business, hold a general meeting of the members of the company, which shall be called "the statutory meeting."*

(2) *The directors shall, at least fourteen days before the day on which the meeting is held, forward a report (in this Act referred to as "the statutory report") to every member of the company;*

Provided that if the statutory report is forwarded later than is required by this subsection, it shall, notwithstanding that fact, be deemed to have been duly forwarded if it is so agreed by all the members entitled to attend and vote at the meeting.

(3) The statutory report shall be certified by not less than two directors of the company and shall state—

(*a*) the total number of shares allotted, distinguishing shares allotted as fully or partly paid up otherwise than in cash, and stating in the case of shares partly paid up the extent to which they are so paid up, and in either case the consideration for which they have been allotted;

(*b*) the total amount of cash received by the company in respect of all the shares allotted, distinguished as aforesaid;

(*c*) an abstract of the receipts of the company and of the payments made thereout, up to a date within seven days of the date of the report, exhibiting under distinctive headings the receipts of the company from shares and debentures and other sources, the payments made thereout, and particulars concerning the balance remaining in hand, and an account or estimate of the preliminary expenses of the company;

(*d*) the names, addresses and descriptions of the directors, auditors, if any, managers, if any, and secretary of the company; and

(*e*) the particulars of any contract the modification of which is to be submitted to the meeting for its approval, together with the particulars of the modification or proposed modification.

(4) *The statutory report shall,* so far as it relates to the shares allotted by the company, and to the cash received in respect of such shares, and to the receipts and payments of the company on capital account, *be certified as correct by the auditors, if any, of the company.*

(5) The directors shall cause *a copy of the statutory report,* certified as required by this section, *to be delivered to the registrar of companies* for registration forthwith after the sending thereof to the members of the company.

(9) [*Here follows a penalty clause for failure to comply.*]

(10) *This section shall not apply to a private company.*

ACCOUNTS AND AUDIT

Keeping of Books of Account

Sect. 147.—(1) *Every company shall cause to be kept proper books of account with respect to*—

(*a*) *all sums of money received and expended* by the company and the matters in respect of which the receipt and expenditure takes place;

(*b*) *all sales and purchases of goods* by the company;

(*c*) *the assets and liabilities* of the company.

(2) For the purposes of the foregoing subsection, proper books of account shall not be deemed to be kept with respect to the matters aforesaid if there are not kept such books as are necessary to give a true and fair view of the state of the company's affairs and to explain its transactions.

(3) *The books of account shall be kept at the registered office of the company or at such other place as the directors think fit*, and shall at all times be open to inspection by the directors:

Provided that *if books of account are kept at a place outside Great Britain there shall be sent to*, and kept at a place in, *Great Britain* and be at all times open to inspection by the directors *such accounts and returns* with respect to the business dealt with in the books of account so kept *as will disclose with reasonable accuracy the financial position of that business at intervals not exceeding six months* and will enable to be prepared in accordance with this Act the company's balance sheet, its profit and loss account or income and expenditure account, and any document annexed to any of those documents giving information which is required by this Act and is thereby allowed to be so given.

(4) [*Here follows a penalty clause for failure to comply.*]

Profit and Loss Account and Balance Sheet

Sect. 148.—(1) *The directors of every company shall* at some date not later than eighteen months after the incorporation of the company and subsequently *once at least in every calendar year lay before the company in general meeting a profit and loss account or*, in the case of a company not trading for profit, *an income and expenditure account for the period*, in the case of the first account, since the incorporation of the company, and, in any other case, since the preceding account, *made up to a date not earlier than the date of the meeting by more than nine months, or, in the case of a company carrying on business or having interests abroad, by more than twelve months*:

Provided that the Board of Trade, if for any special reason they think fit so to do, may, in the case of any company, extend the period of eighteen months aforesaid, and in the case of any company and with respect to any year extend the periods of nine and twelve months aforesaid.

(2) *The directors shall cause to be made out* in every calendar year, *and to be laid before the company in general meeting, a balance sheet as at the date to which the profit and loss account* or the income and expenditure account, as the case may be, *is made up*.

(3) [*Here follows a penalty clause for failure to comply.*]

GENERAL PROVISIONS AS TO CONTENTS AND FORM OF ACCOUNTS

Sect. 149.—(1) *Every balance sheet of a company shall give a true and fair view of the state of affairs of the company as at the end of its financial year, and every profit and loss account of a company shall give a true and fair view of the profit or loss of the company for the financial year.*

(2) *A company's balance sheet and profit and loss account shall comply with the requirements of the Eighth Schedule to this Act,* [*reproduced* in extenso *after Sect.* 459 *of the Act*] so far as applicable thereto [*but see Sect.* 454].

(3) Save as expressly provided in the following provisions of this section or in Part III of the said Eighth Schedule, the requirements of the last foregoing subsection and the said Eighth Schedule shall be without prejudice either to the general requirements of subsection (1) of this section or to any other requirements of this Act.

(4) *The Board of Trade may,* on the application or with the consent of a company's directors, *modify* in relation to that company *any of the requirements of this Act as to the matters to be stated in a company's balance sheet or profit and loss account* (except the requirements of subsection (1) of this section) for the purpose of adapting them to the circumstances of the company.

(5) Subsections (1) and (2) of this section shall not apply to a company's profit and loss account if—

(*a*) the company has subsidiaries; and

(*b*) the profit and loss account is framed as a consolidated profit and loss account dealing with all or any of the company's subsidiaries as well as the company and—

(i) complies with the requirements of this Act relating to consolidated profit and loss accounts; and

(ii) shows how much of the consolidated profit or loss for the financial year is dealt with in the accounts of the company.

(6) [*Here follows a penalty clause for failure to comply.*]

(7) For the purposes of this section and the following provisions of this Act, except where the context otherwise requires—

(*a*) any reference to a balance sheet or profit and loss account shall include any notes thereon or document annexed thereto giving information which is required by this Act and is thereby allowed to be so given; and

(*b*) any reference to a profit and loss account shall be taken, in the case of a company not trading for profit, as referring to its income and expenditure account, and references to profit or to loss and, if the company has subsidiaries, references to a consolidated profit and loss account shall be construed accordingly.

OBLIGATION TO LAY GROUP ACCOUNTS BEFORE HOLDING COMPANY

Sect. 150.—(1) *Where* at the end of its financial year *a company has subsidiaries,* accounts or statements (in this Act referred to as "*group accounts*") *dealing* as hereinafter mentioned *with the state of affairs and profit or loss of the company and the subsidiaries shall,* subject to the next following subsection,

be laid before the Company in general meeting when the company's own balance sheet and profit and loss account are so laid.

(2) Notwithstanding anything in the foregoing subsection—

(*a*) *group accounts shall not be required where the company is* at the end of its financial year *the wholly owned subsidiary of another body corporate* incorporated in Great Britain; and

(*b*) *group accounts need not deal with a subsidiary of the company if the company's directors are of opinion that*—

(i) *it is impracticable, or would be of no real value* to members of the company, in view of the insignificant amounts involved, or would involve expense or delay out of proportion to the value to members of the company; or

(ii) *the result would be misleading, or harmful to the business* of the company or any of its subsidiaries; or

(iii) *the business of the holding company and that of the subsidiary are so different that they cannot reasonably be treated as a single undertaking*;

and, if the directors are of such an opinion about each of the company's subsidiaries, group accounts shall not be required:

Provided that *the approval of the Board of Trade shall be required* for not dealing in group accounts with a subsidiary *on the ground that the result would be harmful or on the ground of the difference between the business of the holding company and that of the subsidiary.*

(3) [*Here follows a penalty clause for failure to comply.*]

(4) For the purposes of this section a body corporate shall be deemed to be the wholly owned subsidiary of another if it has no members except that other and that other's wholly owned subsidiaries and its or their nominees.

FORM OF GROUP ACCOUNTS

Sect. 151.—(1) Subject to the next following subsection, the *group accounts* laid before a holding company *shall be consolidated accounts comprising*—

(*a*) *a consolidated balance sheet* dealing with the state of affairs of the company and all the subsidiaries to be dealt with in group accounts;

(*b*) *a consolidated profit and loss account* dealing with the profit or loss of the company and those subsidiaries.

(2) *If the company's directors are of opinion that it is better for the purpose*—

(*a*) of presenting the same or equivalent information about the state of affairs and profit or loss of the company and those subsidiaries; and

(*b*) of so presenting it that it may be readily appreciated by the company's members;

the group accounts may be prepared in a form other than that required by the foregoing subsection, and in particular may consist of more than one set of consolidated accounts dealing respectively with the company and one group of subsidiaries and with other groups of subsidiaries or of separate accounts dealing with each of the subsidiaries, or of statements expanding the information about the subsidiaries in the company's own accounts, or any combination of those forms.

(3) *The group accounts may be wholly or partly incorporated in the company's own balance sheet and profit and loss account.*

Contents of Group Accounts

Sect. 152.—(1) *The group accounts* laid before a company *shall give a true and fair view of the state of affairs and profit or loss of the company and the subsidiaries* dealt with thereby as a whole, *so far as concerns members of the company.*

(2) Where the financial year of a subsidiary does not coincide with that of the holding company, the group accounts shall, unless the Board of Trade on the application or with the consent of the holding company's directors otherwise direct, deal with the subsidiary's state of affairs as at the end of its financial year ending with or last before that of the holding company, and with the subsidiary's profit or loss for that financial year.

(3) Without prejudice to subsection (1) of this section, *the group accounts,* if prepared as consolidated accounts, *shall comply with the requirements of the Eighth Schedule to this Act* [*reproduced* in extenso *after Sect.* 459 *of the Act*], so far as applicable thereto, and if not so prepared shall give the same or equivalent information:

Provided that the Board of Trade may, on the application or with the consent of a company's directors, modify the said requirements in relation to that company for the purpose of adapting them to the circumstances of the company.

Financial Year of Holding Company and Subsidiary

Sect. 153.—(1) *A holding company's directors shall secure that* except where in their opinion there are good reasons against it, *the financial year of each of its subsidiaries shall coincide with the company's own financial year.*

(2) Where it appears to the Board of Trade desirable for a holding company or a holding company's subsidiary to extend its financial year so that the subsidiary's financial year may end with that of the holding company, and for that purpose to postpone the submission of the relevant accounts to a general meeting from one calendar year to the next, the Board may on the application or with the consent of the directors of the company whose financial year is to be extended direct that, in the case of that company, the submission of accounts to a general meeting, the holding of an annual general meeting or the making of an annual return shall not be required in the earlier of the said calendar years.

Meaning of "Holding Company" and "Subsidiary"

Sect. 154.—(1) For the purposes of this Act, *a company shall,* subject to the provisions of subsection (3) of this section, *be deemed to be a subsidiary of another if, but only if,—*

(*a*) *that other either—*

(i) *is a member of it and controls the composition of its board of directors*; *or*

(ii) *holds more than half in nominal value of its equity share capital*; *or*

(*b*) *the first-mentioned company is a subsidiary of any company which is that other's subsidiary.*

(2) For the purposes of the foregoing subsection, the composition of a company's board of directors shall be deemed to be controlled by another company if, but only if, that other company by the exercise of some power exercisable by it without the consent or concurrence of any other person can appoint or remove the holders of all or a majority of the directorships; but for the purposes of this provision that other company shall be deemed to have power to appoint to a directorship with respect to which any of the following conditions is satisfied, that is to say—

(*a*) that a person cannot be appointed thereto without the exercise in his favour by that other company of such a power as aforesaid; or

(*b*) that a person's appointment thereto follows necessarily from his appointment as director of that other company; or

(*c*) that the directorship is held by that other company itself or by a subsidiary of it.

(3) In determining whether one company is a subsidiary of another—

(*a*) any shares held or power exercisable by that other in a fiduciary capacity shall be treated as not held or exercisable by it;

(*b*) subject to the two following paragraphs, any shares held or power exercisable—

(i) by any person as a nominee for that other (except where that other is concerned only in a fiduciary capacity); or

(ii) by, or by a nominee for, a subsidiary of that other, not being a subsidiary which is concerned only in a fiduciary capacity;

shall be treated as held or exercisable by that other;

(*c*) any shares held or power exercisable by any person by virtue of the provisions of any debentures of the first-mentioned company or of a trust deed for securing any issue of such debentures shall be disregarded;

(*d*) any shares held or power exercisable by, or by a nominee for, that other or its subsidiary (not being held or exercisable as mentioned in the last foregoing paragraph) shall be treated as not held or exercisable by that other if the ordinary business of that other or its subsidiary, as the case may be, includes the lending of money and the shares are held or power is exercisable as aforesaid by way of security only for the purposes of a transaction entered into in the ordinary course of that business.

(4) For the purposes of this Act, a company shall be deemed to be another's holding company if, but only if, that other is its subsidiary.

(5) In this section the expression "company" includes any body corporate, and the expression "equity share capital" means, in relation to a company, its issued share capital excluding any part thereof which, neither as respects dividends nor as respects capital, carries any right to participate beyond a specified amount in a distribution.

Signing of Balance Sheet

Sect. 155.—(1) *Every balance sheet* of a company *shall be signed* on behalf of the board *by two of the directors* of the company, or, if there is only one director, by that director.

(2) In the case of a banking company registered after the fifteenth day of August, eighteen hundred and seventy-nine, the balance sheet must be signed by the secretary or manager, if any, and where there are more than three directors of the company by at least three of those directors, and where there are not more than three directors by all the directors.

(3) [*Here follows a penalty clause for failure to comply.*]

ACCOUNTS AND AUDITORS' REPORT TO BE ANNEXED TO BALANCE SHEET

Sect. 156.—(1) *The profit and loss account and,* so far as not incorporated in the balance sheet or profit and loss account, *any group accounts* laid before the company in general meeting, *shall be annexed to the balance sheet, and the auditors' report shall be attached thereto.*

(2) Any accounts so annexed shall be approved by the board of directors before the balance sheet is signed on their behalf.

(3) [*Here follows a penalty clause for failure to comply.*]

DIRECTORS' REPORT TO BE ATTACHED TO BALANCE SHEET

Sect. 157.—(1) *There shall be attached to every balance sheet* laid before a company in general meeting *a report by the directors with respect to the state of the company's affairs, the amount, if any, which they recommend should be paid by way of dividend, and the amount, if any, which they propose to carry to reserves* within the meaning of the Eighth Schedule to this Act [*reproduced* in extenso *after Sect.* 459 *of the Act*].

(2) *The said report shall deal,* so far as is material for the appreciation of the state of the company's affairs by its members and will not in the directors' opinion be harmful to the business of the company or of any of its subsidiaries, *with any change during the financial year in the nature of the company's business, or in the company's subsidiaries, or in the classes of business in which the company has an interest,* whether as member of another company or otherwise.

(3) [*Here follows a penalty clause for failure to comply.*]

RIGHT TO RECEIVE COPIES OF BALANCE SHEETS AND AUDITORS' REPORT

Sect. 158.—(1) *A copy of every balance sheet,* including every document required by law to be annexed thereto, which is to be laid before a company in general meeting, *together with a copy of the auditors' report, shall, not less than twenty-one days before the date of the meeting, be sent to every member of the company* (whether he is or is not entitled to receive notices of general meetings of the company), *every holder of debentures of the company* (whether he is or is not so entitled) *and all persons* other than members or holders of debentures of the company, being persons *so entitled:*

Provided that—

(*a*) in the case of a company not having a share capital this subsection shall not require the sending of a copy of the documents aforesaid to a member of the company who is not entitled to receive notices of general meetings of the company or to a holder of debentures of the company who is not so entitled;

(*b*) this subsection shall not require a copy of those documents to be sent—

(i) to a member of the company or a holder of debentures of the company, being in either case a person who is not entitled to receive notices of general meetings of the company and of whose address the company is unaware;

(ii) to more than one of the joint holders of any shares or debentures none of whom are entitled to receive such notices; or

(iii) in the case of joint holders of any shares or debentures some of whom are and some of whom are not entitled to receive such notices, to those who are not so entitled; and

(*c*) if the copies of the documents aforesaid are sent less than twenty-one days before the date of the meeting, they shall, notwithstanding that fact, be deemed to have been duly sent if it is so agreed by all the members entitled to attend and vote at the meeting.

(2) *Any member of a company,* whether he is or is not entitled to have sent to him copies of the company's balance sheets, *and any holder of debentures of the company,* whether he is or is not so entitled, *shall be entitled to be furnished on demand without charge with a copy of the last balance sheet* of the company, including every document required by law to be annexed thereto, together with a copy of the auditors' report on the balance sheet.

(3) [*Here follows a penalty clause for failure to comply.*]

(4) The foregoing provisions of this section shall not have effect in relation to a balance sheet of a private company laid before it before the commencement of this Act, and the right of any person to be furnished with a copy of any such balance sheet and the liability of the company in respect of a failure to satisfy that right shall be the same as they would have been if this Act had not passed.

Appointment and Remuneration of Auditors

Sect. 159.—(1) *Every company shall at each annual general meeting appoint an auditor or auditors* to hold office from the conclusion of that, until the conclusion of the next, annual general meeting.

(2) At any annual general meeting *a retiring auditor,* however appointed, *shall be reappointed without any resolution being passed unless—*

(*a*) *he is not qualified* for reappointment; or

(*b*) *a resolution has been passed* at that meeting appointing somebody instead of him or *providing expressly that he shall not be reappointed*; or

(*c*) *he has given the company notice in writing of his unwillingness to be reappointed*;

Provided that where notice is given of an intended resolution to appoint some person or persons in place of a retiring auditor, and by reason of the death, incapacity or disqualification of that person or of all those persons, as the case may be, the resolution cannot be proceeded with, the retiring auditor shall not be automatically reappointed by virtue of this subsection.

(3) Where at an annual general meeting no auditors are appointed or reappointed, the Board of Trade may appoint a person to fill the vacancy.

(4) The company shall, within one week of the Board's power under the last foregoing subsection becoming exercisable, give them notice of that fact, and, if a company fails to give notice as required by this subsection, the company and every officer of the company who is in default shall be liable to a default fine.

(5) Subject as hereinafter provided, *the first auditors of a company may be appointed by the directors* at any time before the first annual general meeting, and auditors so appointed shall hold office until the conclusion of that meeting:

Provided that—

(*a*) *the company may at a general meeting remove any such auditors* and appoint in their place any other persons who have been nominated for appointment by any member of the company and of whose nomination notice has been given to the members of the company not less than fourteen days before the date of the meeting; and

(*b*) if the directors fail to exercise their powers under this subsection, the company in general meeting may appoint the first auditors, and thereupon the said powers of the directors shall cease.

(6) *The directors may fill any casual vacancy in the office of auditor*, but while any such vacancy continues, the surviving or continuing auditor or auditors, if any, may act.

(7) *The remuneration of the auditors of a company—*

(*a*) in the case of an auditor appointed by the directors or by the Board of Trade, *may be fixed by the directors or by the Board, as the case may be*;

(*b*) subject to the foregoing paragraph, shall be fixed by the company in general meeting *or in such manner as the company in general meeting may determine.*

For the purposes of this subsection, any sums paid by the company in respect of the auditors' expenses shall be deemed to be included in the expression "remuneration."

Resolutions Relating to Appointment and Removal of Auditors

Sect. 160.—(1) *Special notice shall be required for a resolution* at a company's annual general meeting *appointing as auditor a person other than a retiring auditor or providing expressly that a retiring auditor shall not be reappointed.*

(2) On receipt of notice of such an intended resolution as aforesaid, *the company shall forthwith send a copy thereof to the retiring auditor (if any).*

(3) *Where* notice is given of such an intended resolution as aforesaid and *the retiring auditor makes* with respect to the intended resolution *representations in writing to the company* (not exceeding a reasonable length) *and requests their notification to members of the company, the company shall,* unless the representations are received by it too late for it to do so—

(*a*) in any notice of the resolution given to members of the company, *state the fact of the representations having been made*; *and*

(*b*) *send a copy of the representations to every member* of the company to whom notice of the meeting is sent (whether before or after receipt of the representations by the company);

and *if a copy of the representations is not sent as aforesaid* because received too late or because of the company's default, *the auditor may* (without prejudice to his right to be heard orally) *require that the representations shall be read out at the meeting*:

Provided that copies of the representations need not be sent out and the representations need not be read out at the meeting if, on the application either of the company or of any other person who claims to be aggrieved, the court is satisfied that the rights conferred by this section are being abused to secure needless publicity for defamatory matter; and the court may order the company's costs on an application under this section to be paid in whole or in part by the auditor, notwithstanding that he is not a party to the application.

(4) The last foregoing subsection shall apply to a resolution to remove the first auditors by virtue of subsection (5) of the last foregoing section as it applies in relation to a resolution that a retiring auditor shall not be reappointed.

DISQUALIFICATIONS FOR APPOINTMENT AS AUDITOR

Sect. 161.—(1) *A person shall not be qualified for appointment as auditor* of a company *unless either*—

(*a*) *he is a member of a body of accountants established in the United Kingdom and for the time being recognized* for the purposes of this provision *by the Board of Trade*; or

(*b*) *he is for the time being authorized by the Board of Trade to be so appointed* either as having similar qualifications obtained outside the United Kingdom or as having obtained adequate knowledge and experience in the course of his employment by a member of a body of accountants recognized for the purposes of the foregoing paragraph or as having before the sixth day of August, nineteen hundred and forty-seven, practised in Great Britain as an accountant:

Provided that this subsection shall not apply in the case of a private company which at the time of the auditor's appointment is *an exempt private company*.

(2) *None of the following persons shall be qualified for appointment as auditor* of a company—

(*a*) *an officer or servant of the company*;

(*b*) *a person who is a partner of or in the employment of an officer or servant of the company*;

(*c*) *a body corporate*:

Provided that *paragraph* (*b*) of this subsection *shall not apply in the case of* a private company which at the time of the auditor's appointment is *an exempt private company*.

References in this subsection to an officer or servant shall be construed as not including references to an auditor.

(3) *A person shall also not be qualified for appointment as auditor* of a company *if he is*, by virtue of the last foregoing subsection, *disqualified for* appointment as auditor of any other body corporate which is *that company's subsidiary*

or holding company or a subsidiary of that company's holding company, or would be so disqualified if the body corporate were a company.

(4) Notwithstanding anything in the foregoing provisions of this section, *a Scottish firm shall be qualified* for appointment as auditor of a company if, but *only if, all the partners are qualified for appointment* as auditor thereof.

(5) Any body corporate which acts as auditor of a company shall be liable to a fine not exceeding one hundred pounds.

Auditors' Report and Right of Access to Books and to Attend and be Heard at General Meetings

Sect. 162.—(1) *The auditors shall make a report to the members on the accounts examined by them, and on every balance sheet, every profit and loss account and all group accounts* laid before the company in general meeting during their tenure of office, *and the report shall contain statements as to the matters mentioned in the Ninth Schedule to this Act [reproduced below].*

(2) *The auditors' report shall be read before the company* in general meeting and shall be open to inspection by any member.

(3) *Every auditor* of a company *shall have a right of access at all times to the books and accounts and vouchers of the company, and shall be entitled to require from the officers* of the company *such information and explanation as he thinks necessary* for the performance of the duties of the auditors.

(4) *The auditors* of a company *shall be entitled to attend any general meeting* of the company *and to receive all notices* of and other communications relating to any general meeting which any member of the company is entitled to receive *and to be heard at any general meeting* which they attend on any part of the business of the meeting which concerns them as auditors.

NINTH SCHEDULE

MATTERS TO BE EXPRESSLY STATED IN AUDITORS' REPORT

Para. 1. *Whether they have obtained all the information and explanations which* to the best of their knowledge and belief *were necessary* for the purposes of their audit.

Para. 2. *Whether*, in their opinion, *proper books of account have been kept* by the company, so far as appears from their examination of those books, *and proper returns* adequate for the purposes of their audit *have been received from branches not visited by them.*

Para. 3.—(1) *Whether the company's balance sheet and* (unless it is framed as a consolidated profit and loss account) *profit and loss account* dealt with by the report *are in agreement with the books of account and returns.*

(2) *Whether*, in their opinion and to the best of their information and according to the explanations given them, *the said accounts give the information required by this Act* in the manner so required *and give a true and fair view—*

(*a*) *in the case of the balance sheet, of the state of the company's affairs as at the end of its financial year*; *and*

(*b*) *in the case of the profit and loss account, of the profit or loss for its financial year*;

or, as the case may be, give a true and fair view thereof subject to the non-disclosure of any matters (to be indicated in the report) which by virtue of Part III of the Eighth Schedule to this Act [*reproduced* in extenso *after Sect.* 459 *of the Act*] are not required to be disclosed.

Para. 4. *In the case of a holding company* submitting group accounts *whether*, in their opinion, *the group accounts have been properly prepared* in accordance with the provisions of this Act *so as to give a true and fair view of the state of affairs and profit or loss of the company and its subsidiaries* dealt with thereby, *so far as concerns members of the company*, or, as the case may be, so as to give a true and fair view thereof subject to the non-disclosure of any matters (to be indicated in the report) which by virtue of Part III of the Eighth Schedule to this Act [*reproduced* in extenso *after Sect.* 459 *of the Act*] are not required to be disclosed.

CONSTRUCTION OF REFERENCES TO DOCUMENTS ANNEXED TO ACCOUNTS

Sect. 163. References in this Act to a document annexed or required to be annexed to a company's accounts or any of them shall not include the directors' report or the auditors' report:

Provided that any information which is required by this Act to be given in accounts, and is thereby allowed to be given in a statement annexed, may be given in the directors' report instead of in the accounts and, if any such information is so given, the report shall be annexed to the accounts and this Act shall apply in relation thereto accordingly, except that the auditors shall report thereon only so far as it gives the said information.

DIRECTORS AND OFFICERS OF THE COMPANY

PROHIBITION OF TAX-FREE PAYMENTS TO DIRECTORS

Sect. 189.—(1) *It shall not be lawful for a company to pay a director remuneration* (whether as director or otherwise) *free of income tax* or of income tax other than surtax, or otherwise calculated by reference to or varying with the amount of his income tax or his income tax other than surtax, or to or with the rate or standard rate of income tax, *except under a contract which was in force on the eighteenth day of July, nineteen hundred and forty-five*, and provides expressly, and not by reference to the articles, for payment of remuneration as aforesaid.

(2) Any provision contained in a company's articles, or in any contract other than such a contract as aforesaid, or in any resolution of a company or a company's directors, for payment to a director of remuneration as aforesaid shall have effect as if it provided for payment, as a gross sum subject to income tax and surtax, of the net sum for which it actually provides.

(3) This section shall not apply to remuneration due before the commencement of this Act or in respect of a period before the commencement of this Act.

PROHIBITION OF LOANS TO DIRECTORS

Sect. 190.—(1) *It shall not be lawful for a company to make a loan to any person who is its director* or a director of its holding company, or to enter into any guarantee or provide any security in connection with a loan made to such a person as aforesaid by any other person:

Provided that nothing in this section shall apply either—

(*a*) *to* anything done by a company which is for the time being *an exempt private company*; or

(*b*) *to anything done by a subsidiary, where the director is its holding company;* or

(*c*) subject to the next following subsection, *to anything done to provide any such person as aforesaid with funds to meet expenditure incurred or to be incurred by him for the purposes of the company* or for the purpose of enabling him properly to perform his duties as an officer of the company; or

(*d*) *in the case of a company whose ordinary business includes the lending of money* or the giving of guarantees in connection with loans made by other persons, to anything done by the company in the ordinary course of that business.

(2) *Proviso* (*c*) *to the foregoing subsection shall not authorize the making of any oan*, or the entering into any guarantee, or the provision of any security, *except either*—

(*a*) *with the prior approval of the company given at a general meeting* at which the purposes of the expenditure and the amount of the loan or the extent of the guarantee or security, as the case may be, are disclosed; or

(*b*) *on condition that, if the approval of the company is not given as aforesaid at or before the next following annual general meeting, the loan shall be repaid* or the liability under the guarantee or security shall be discharged, as the case may be, *within six months* from the conclusion of that meeting.

(3) Where the approval of the company is not given as required by any such condition, the directors authorizing the making of the loan, or the entering into the guarantee, or the provision of the security, shall be jointly and severally liable to indemnify the company against any loss arising therefrom.

Approval of Company Requisite for Payment by it to Director for Loss of Office, Etc.

Sect. 191. *It shall not be lawful for a company to make to any director of the company any payment by way of compensation for loss of office*, or as consideration for or in connection with his retirement from office, *without* particulars with respect to the proposed payment (including the amount thereof) being disclosed to members of the company and *the proposal being approved by the company.*

Approval of Company Requisite for any Payment, in Connection with Transfer of its Property, to Director for Loss of Office, Etc.

Sect. 192.—(1) It is hereby declared that *it is not lawful in connection with the transfer of the whole or any part of the undertaking or property of a company for any payment to be made to any director of the company by way of compensation for loss of office*, or as consideration for or in connection with his retirement from office, *unless* particulars with respect to the proposed payment (including the amount thereof) have been disclosed to the members of the company and *the proposal approved by the company.*

(2) Where a payment which is hereby declared to be illegal is made to a director of the company, the amount received shall be deemed to have been received by him in trust for the company.

Duty of Director to Disclose Payment for Loss of Office, Etc., made in Connection with Transfer of Shares in Company

Sect. 193.—(1) Where, in connection with the transfer to any persons of all or any of the shares in a company, being a transfer resulting from—

(*a*) an offer made to the general body of shareholders;

(*b*) an offer made by or on behalf of some other body corporate with a view to the company becoming its subsidiary or a subsidiary of its holding company;

(*c*) an offer made by or on behalf of an individual with a view to his obtaining the right to exercise or control the exercise of not less than one-third of the voting power at any general meeting of the company; or

(*d*) any other offer which is conditional on acceptance to a given extent;

a payment is to be made to a director of the company by way of compensation for loss of office, or as consideration for or in connection with his retirement from office, it shall be the duty of that director to take all reasonable steps to secure that particulars with respect to the proposed payment (including the amount thereof) shall be included in or sent with any notice of the offer made for their shares which is given to any shareholders.

(2) If—

(*a*) any such director fails to take reasonable steps as aforesaid; or

(*b*) any person who has been properly required by any such director to include the said particulars in or send them with any such notice as aforesaid fails so to do;

he shall be liable to a fine not exceeding twenty-five pounds.

(3) If—

(*a*) the requirements of subsection (1) of this section are not complied with in relation to any such payment as is therein mentioned; or

(*b*) the making of the proposed payment is not, before the transfer of any shares in pursuance of the offer, approved by a meeting summoned for the purpose of the holders of the shares to which the offer relates and of other holders of shares of the same class as any of the said shares;

any sum received by the director on account of the payment shall be deemed to have been received by him in trust for any persons who have sold their shares as a result of the offer made, and the expenses incurred by him in distributing that sum amongst those persons shall be borne by him and not retained out of that sum.

(4) Where the shareholders referred to in paragraph (*b*) of the last foregoing subsection are not all the members of the company and no provision is made by the articles for summoning or regulating such a meeting as is mentioned in that paragraph, the provisions of this Act and of the company's articles relating to general meetings of the company shall,

for that purpose, apply to the meeting either without modification or with such modifications as the Board of Trade on the application of any person concerned may direct for the purpose of adapting them to the circumstances of the meeting.

(5) If a meeting summoned for the purpose of approving any payment as required by paragraph (*b*) of subsection (3) of this section a quorum is not present and, after the meeting has been adjourned to a later date, a quorum is again not present, the payment shall be deemed for the purposes of that subsection to have been approved.

PROVISIONS SUPPLEMENTARY TO THREE FOREGOING SECTIONS

Sect. 194.—(1) Where in proceedings for the recovery of any payment as having, by virtue of subsections (1) and (2) of the last but one foregoing section or subsections (1) and (3) of the last foregoing section, been received by any person in trust, it is shown that—

(*a*) the payment was made in pursuance of any arrangement entered into as part of the agreement for the transfer in question, or within one year before or two years after that agreement or the offer leading thereto; and

(*b*) the company or any person to whom the transfer was made was privy to that arrangement;

the payment shall be deemed, except in so far as the contrary is shown, to be one to which the subsections apply.

(2) If in connection with any such transfer as is mentioned in either of the two last foregoing sections—

(*a*) the price to be paid to a director of the company whose office is to be abolished or who is to retire from office for any shares in the company held by him is in excess of the price which could at the time have been obtained by other holders of the like shares; or

(*b*) any valuable consideration is given to any such director;

the excess or the money value of the consideration, as the case may be, shall, for the purposes of that section, be deemed to have been a payment made to him by way of compensation for loss of office or as consideration for or in connection with his retirement from office.

(3) It is hereby declared that references in the three last foregoing sections to payments made to any director of a company by way of compensation for loss of office, or as consideration for or in connection with his retirement from office, do not include any bona fide payment by way of damages for breach of contract or by way of pension in respect of past services, and for the purposes of this subsection the expression "pension" includes any superannuation allowance, superannuation gratuity or similar payment.

(4) Nothing in the two last foregoing sections shall be taken to prejudice the operation of any rule of law requiring disclosure to be made with respect to any such payments as are therein mentioned or with respect to any other like payments made or to be made to the directors of a company.

REGISTER OF DIRECTORS' SHAREHOLDINGS, ETC.

Sect. 195.—(1) *Every company shall keep a register showing as respects each director of the company* (not being its holding company) *the number, description and amount of any shares in or debentures of* the company or any other body corporate, being the company's subsidiary or holding company, or a subsidiary of the company's holding company, *which are held by* or in trust for *him* or of which he has any right to become the holder (whether on payment or not):

Provided that the register need not include shares in any body corporate which is the wholly-owned subsidiary of another body corporate, and for this purpose a body corporate shall be deemed to be the wholly-owned subsidiary of another if it has no members but that other and that other's wholly-owned subsidiaries and its or their nominees.

(2) Where any shares or debentures fall to be or cease to be recorded in the said register in relation to any director by reason of a transaction entered into after the commencement of this Act and while he is a director, *the register shall also show the date of, and price or other consideration for, the transaction*:

Provided that where there is an interval between the agreement for any such transaction and the completion thereof, the date shall be that of the agreement.

(3) The nature and extent of a director's interest or right in or over any shares or debentures recorded in relation to him in the said register shall, if he so requires, be indicated in the register.

(4) The company shall not, by virtue of anything done for the purposes of this section, be affected with notice of, or put upon inquiry as to, the rights of any person in relation to any shares or debentures.

(5) *The said register shall,* subject to the provisions of this section, *be kept at the company's registered office and shall be open to inspection* during business hours (subject to such reasonable restrictions as the company may by its articles or in general meeting impose, so that not less than two hours in each day be allowed for inspection) *as follows—*

(*a*) *during the period beginning fourteen days before the date of the company's annual general meeting and ending three days after the date of its conclusion, it shall be open to the inspection of any member or holder of debentures of the company*; *and*

(*b*) *during that or any other period,* it shall be open *to* the inspection of *any person acting on behalf of the Board of Trade.*

In computing the fourteen days and the three days mentioned in this subsection, any day which is a Saturday or Sunday or a bank holiday shall be disregarded.

(6) Without prejudice to the rights conferred by the last foregoing subsection, the Board of Trade may at any time require a copy of the said register, or any part thereof.

(7) *The said register shall also* be produced at the commencement of the company's annual general meeting and *remain open and accessible during the continuance of the meeting to any person attending* the meeting.

(8) [*Here follows a penalty clause for failure to comply.*]

(9) In the case of any such refusal, the court may by order compel an immediate inspection of the register.

(10) For the purposes of this section—

(*a*) any person in accordance with whose directions or instructions the directors of a company are accustomed to act shall be deemed to be a director of the company; and

(*b*) a director of a company shall be deemed to hold, or to have any interest or right in or over, any shares or debentures if a body corporate other than the company holds them or has that interest or right in or over them, and either—

(i) that body corporate or its directors are accustomed to act in accordance with his directions or instructions; or

(ii) he is entitled to exercise or control the exercise of one-third or more of the voting power at any general meeting of that body corporate.

PARTICULARS IN ACCOUNTS OF DIRECTORS' SALARIES, PENSIONS, ETC.

Sect. 196.—(1) *In any accounts* of a company laid before it in general meeting, or in a statement annexed thereto, *there shall*, subject to and in accordance with the provisions of this section, *be shown* so far as the information is contained in the company's books and papers or the company has the right to obtain it from the persons concerned—

(*a*) the aggregate amount of *the directors' emoluments*;

(*b*) the aggregate amount of *directors' or past directors' pensions*; and

(*c*) the aggregate amount of *any compensation to directors or past directors in respect of loss of office.*

(2) *The amount to be shown* under paragraph (*a*) of subsection (1) of this section—

(*a*) *shall include any emoluments* paid to or receivable by any person in respect of his services as director of the company or *in respect of his services, while director of the company, as director of any subsidiary thereof or otherwise* in connection with the management of the affairs of the company or any subsidiary thereof; and

(*b*) *shall distinguish between emoluments in respect of services as director,* whether of the company or its subsidiary, *and other emoluments*;

and for the purposes of this section the expression "*emoluments*," in relation to a director, *includes fees and percentages, any sums paid by way of expenses allowance in so far as those sums are charged to United Kingdom income tax*, any contribution paid in respect of him under *any pension scheme and the* estimated *money value of any other benefits* received by him otherwise than in cash.

(3) The amount to be shown under paragraph (*b*) of the said subsection (1)—[*Here follows an explanatory clause.*]

(4) The amount to be shown under paragraph (*c*) of the said subsection (1)—[*Here follows an explanatory clause.*]

(5) The amounts to be shown under each paragraph of the said subsection (1)—

(*a*) shall include all relevant sums paid by or receivable from—

(i) the company; and

(ii) the company's subsidiaries; and

(iii) any other person;

except sums to be accounted for to the company or any of its subsidiaries or, by virtue of section one hundred and ninety-three of this Act, to past or present members of the company or any of its subsidiaries or any class ot those members; and

(*b*) shall distinguish, in the case of the amount to be shown under paragraph (*c*) of the said subsection (1), between the sums respectively paid by or receivable from the company, the company's subsidiaries and persons other than the company and its subsidiaries.

(6) the amounts to be shown under this section for any financial year shall be the sums receivable in respect of that year, whenever paid, or, in the case of sums not receivable in respect of a period, the sums paid during that year, so, however, that where—

(*a*) any sums are not shown in the accounts for the relevant financial year on the ground that the person receiving them is liable to account therefor as mentioned in paragraph (*a*) of the last foregoing subsection, but the liability is thereafter wholly or partly released or is not enforced within a period of two years; or

(*b*) any sums paid by way of expenses allowance are charged to United Kingdom income tax after the end of the relevant financial year;

those sums shall, to the extent to which the liability is released or not enforced or they are charged as aforesaid, as the case may be, be shown in the first accounts in which it is practicable to show them or in a statement annexed thereto, and shall be distinguished from the amounts to be shown therein apart from this provision.

(7) Where it is necessary so to do for the purpose of making any distinction required by this section in any amount to be shown thereunder, the directors may apportion any payments between the matters in respect of which they have been paid or are receivable in such manner as they think appropriate.

(8) *If in the case of any accounts the requirements of this section are not complied with, it shall be the duty of the auditors* of the company by whom the accounts are examined *to include in their report* thereon, so far as they are reasonably able to do so, *a statement giving the required particulars.*

(9) In this section any reference to a company's subsidiary—

(*a*) in relation to a person who is or was, while a director of the company, a director also, by virtue of the company's nomination, direct or indirect, of any other body corporate, shall, subject to the following paragraph, include that body corporate, whether or not it is or was in fact the company's subsidiary; and

(*b*) shall for the purposes of subsections (2) and (3) be taken as referring to a subsidiary at the time the services were rendered, and for the purposes of subsection (4) be taken as referring to a subsidiary immediately before the loss of office as director of the company.

[*But see Eighth Schedule, para.* 19 *re consolidated accounts.*]

PARTICULARS IN ACCOUNTS OF LOANS TO OFFICERS, ETC.

Sect. 197.—(1) *The accounts* which, in pursuance of this Act, are to be

laid before every company in general meeting *shall*, subject to the provisions of this section, *contain particulars showing*—

(*a*) *the amount of any loans made* during the company's financial year *to*—

(i) *any officer* of the company; or

(ii) *any person who*, after the making of the loan, *became* during that year *an officer* of the company;

by the company or a subsidiary thereof or by any other person under a guarantee from or on a security provided by the company or a subsidiary thereof (including any such loans which were repaid during that year); and

(*b*) *the amount of any loans made* in manner aforesaid to any such officer or person as aforesaid *at any time before the company's financial year and outstanding at the expiration thereof.*

(2) *The foregoing subsection shall not require the inclusion* in accounts *of particulars* of—

(*a*) *a loan made* in the ordinary course of its business by the company or a subsidiary thereof, *where the ordinary business of the company* or, as the case may be, the subsidiary, *includes the lending of money*; or

(*b*) a loan made by the company or a subsidiary thereof to an employee of the company or subsidiary, as the case may be, *if the loan does not exceed two thousand pounds and is certified by the directors* of the company or subsidiary, as the case may be, *to have been made in accordance with any practice adopted or about to be adopted* by the company or subsidiary *with respect to loans to its employees*;

not being, in either case, a loan made by the company under a guarantee from or on a security provided by a subsidiary thereof or a loan made by a subsidiary of the company under a guarantee from or on a security provided by the company or any other subsidiary thereof.

(3) *If in the case of any such accounts* as aforesaid *the requirements of this section are not complied with, it shall be the duty of the auditors of the company* by whom the accounts are examined *to include in their report* on the balance sheet of the company, so far as they are reasonably able to do so, *a statement giving the required particulars.*

(4) References in this section to a subsidiary shall be taken as referring to a subsidiary at the end of the company's financial year (whether or not a subsidiary at the date of the loan).

[*But see Eighth Schedule, para.* 19 *re consolidated accounts.*]

General Duty to Make Disclosure for Purposes of Three Foregoing Sections

Sect. 198.—(1) *It shall be the duty of any director of a company to give notice to the company of such matters relating to himself as may be necessary* for the purposes of sections one hundred and ninety-five and one hundred and ninety-six of this Act and of the last foregoing section except so far as it relates to loans made, by the company or by any other person under a guarantee from or on a security provided by the company, to an officer thereof.

(2) Any such notice given for the purposes of the said section one

hundred and ninety-five shall be in writing and, if it is not given at a meeting of the directors, the director giving it shall take reasonable steps to secure that it is brought up and read at the next meeting of directors after it is given.

(3) Subsection (1) of this section shall apply—

(*a*) for the purposes of the last foregoing section, in relation to officers other than directors; and

(*b*) for the purposes of the said section one hundred and ninety-six and the last foregoing section, in relation to persons who are or have at any time during the preceding five years been officers;

as it applies in relation to directors.

(4) [*Here follows a penalty clause for failure to comply.*]

COMPANIES INCORPORATED OUTSIDE GREAT BRITAIN

Provisions as to Establishment of Place of Business in Great Britain

Sect. 406. *The next* eight following *sections shall apply to all oversea companies*, that is to say, companies incorporated outside Great Britain *which*, after the commencement of this Act, *establish a place of business within Great Britain*, and companies incorporated outside Great Britain which have, before the commencement of this Act, established a place of business within Great Britain and continue to have an established place of business within Great Britain at the commencement of this Act.

Accounts of Oversea Company

Sect. 410.—(1) *Every oversea company shall*, in every calendar year, *make out a balance sheet and profit and loss account and*, if the company is a holding company, *group accounts*, in such form, and containing such particulars and including such documents, *as under the provisions of this Act* (subject, however, to any prescribed exceptions) it would, if it had been a company within the meaning of this Act, have been required to make out and lay before the company in general meeting, *and deliver copies of those documents to the registrar of companies*:

Provided that a company registered under the law relating to companies for the time being in force in Northern Ireland and having provisions in its constitution which would, if it had been registered in Great Britain, entitle it to rank as a private company, need not comply with the foregoing provisions of this subsection if there is delivered to the registrar a certificate signed by a director and by the secretary of the company that, had section one hundred and twenty-nine of, and the Seventh Schedule to, this Act extended to Northern Ireland it would at the date of the certificate have been an exempt private company.

(2) *If any such document* as is mentioned in the foregoing subsection *is not written in the English language, there shall be annexed to it a certified translation thereof.*

MISCELLANEOUS PROVISIONS WITH RESPECT TO BANKING AND INSURANCE COMPANIES, AND CERTAIN SOCIETIES, PARTNERSHIPS AND UNREGISTERED COMPANIES

Prohibition of Banking Partnerships with More than Ten Members

Sect. 429. *No* company, association or *partnership consisting of more than ten persons shall be formed for the purpose of carrying on the business of banking, unless it is registered as a company under this Act,* or is formed in pursuance of some other Act of Parliament, or of letters patent.

On Registration of Banking Company with Limited Liability, Notice to be Given to Customers

Sect. 430.—(1) Where a banking company which was in existence on the seventh day of August, eighteen hundred and sixty-two, proposes to register as a limited company, it shall, at least thirty days before so registering, give notice of its intention so to register to every person who has a banking account with the company, either by delivery of the notice to him, or by posting it to him at, or delivering it at, his last known address.

(2) If the company omits to give notice required by this section, then, as between the company and the person for the time being interested in the account in respect of which the notice ought to have been given, and so far as respects the account down to the time at which notice is given, but not further or otherwise, the certificate of registration with limited liability shall have no operation.

Banking and Insurance Companies and Deposit, Provident or Benefit Societies to Publish Periodical Statement

Sect. 433.—(1) *Every* company, being a *limited banking company or an insurance company or a deposit, provident, or benefit society, shall,* before it commences business, and also *on the first Monday in February and the first Tuesday in August* in every year during which it carries on business, *make a statement in the form set out in the Thirteenth Schedule to this Act* [*reproduced on p.* 111—*but see Sect.* 454], or as near thereto as circumstances admit.

(2) *A copy of the statement shall be put up in a conspicuous place in the registered office of the company, and in every branch office or place where the business of the company is carried on.*

(3) Every member and every creditor of the company shall be entitled to a copy of the statement, on payment of a sum not exceeding sixpence.

(4) [*Here follows a penalty clause for failure to comply.*]

(5) For the purposes of this Act a company which carries on the business of insurance in common with any other business or businesses shall be deemed to be an insurance company.

(6) This section shall not apply to any assurance company to which the provisions of the Assurance Companies Act, 1909, as to the accounts and balance sheet to be prepared annually and deposited by such a company apply, if the company complies with those provisions.

THIRTEENTH SCHEDULE

FORM OF STATEMENT TO BE PUBLISHED[1]

The share capital[2] of the company is , divided into shares of each.

The number of shares issued is

Calls to the amount of pounds per share have been made, under which the sum of pounds has been received.

The liabilities of the company on the first day of January (*or* July) were—

Debts owing to sundry persons by the company.

On judgment, £

On specialty, £

On notes or bills, £

On simple contracts, £

On estimated liabilities, £

The assets of the company on that day were—

Government securities [*stating them*]

Bills of exchange and promissory notes, £

Cash at the bankers, £

Other securities, £

PROHIBITION OF PARTNERSHIPS WITH MORE THAN TWENTY MEMBERS

Sect. 434.—(1) *No* company, association, or *partnership consisting of more than twenty persons shall be formed* for the purpose of carrying on any business (other than the business of banking) *that has for its object the acquisition of gain* by the company, association, or partnership, or by the individual members thereof, *unless it is registered as a company under this Act*, or is formed in pursuance of some other Act of Parliament, or of letters patent, or is a company engaged in working mines within the stannaries and subject to the jurisdiction of the court exercising the stannaries jurisdiction.

APPLICATION OF CERTAIN PROVISIONS OF THIS ACT TO UNREGISTERED COMPANIES

Sect. 435.—(1) *The provisions of this Act specified in the second column of the Fourteenth Schedule to this Act* [*sections of which are reproduced on p.* 112] (which respectively relate to the matters referred to in the first column of that Schedule) *shall apply to all bodies corporate* incorporated in and *having a principal place of business in Great Britain*, other than those mentioned in the next following subsection, as if they were companies registered under this Act, but subject to any limitations mentioned in relation to those provisions respectively in the third column of that Schedule and to such adaptations and modifications (if any) as may be specified by regulations made by the Board of Trade.

(2) *The said provisions shall not apply* by virtue of this section *to* any of the following, that is to say—

(*a*) *any body incorporated by* or registered under *any public general Act of Parliament*; and

(*b*) *any body not formed for the purpose of* carrying on a business which has for its object *the acquisition of gain* by the body or by the individual members thereof; and

(*c*) *any body* for the time being *exempted by direction of the Board of Trade.*

[1] But see Sect. 454.

[2] If the company has no share capital the portion of the statement relating to capital and shares must be omitted.

FOURTEENTH SCHEDULE

PROVISIONS OF THIS ACT APPLIED TO UNREGISTERED COMPANIES

Subject matter.	*Provisions applied.*	*Limitations on Application.*
Annual return.	Sections one hundred and twenty-four to one hundred and twenty-nine and four hundred and thirty-two, and the Sixth and Seventh Schedules.	Not to apply so as to require particulars in respect of any period before the commencement of this Act, and as respects any period thereafter to apply so far only as may be specified as aforesaid and to such bodies corporate as may be so specified.
Accounts and audit.	Sections one hundred and forty-seven to one hundred and sixty-three, one hundred and ninety-six, one hundred and ninety-seven and four hundred and thirty-three, the Eighth Schedule (except sub-paragraphs (*a*) to (*d*) of paragraph 2, sub-paragraphs (*c*), (*d*) and (*e*) of paragraph 3 and sub-paragraph (1) (*c*) of paragraph 8) and the Ninth Schedule.	To apply so far only as may be specified as aforesaid and to such bodies corporate as may be so specified.

GENERAL

Form of Registers, Etc.

Sect. 436.—(1) *Any register, index, minute book or book of account* required by this Act to be kept by a company *may be kept either by making entries in bound books or by recording the matters in question in any other manner.*

(2) Where any such register, index, minute book or book of account is not kept by making entries in a bound book, but by some other means, *adequate precautions shall be taken for guarding against falsification and facilitating its discovery*, and [*here follows a penalty clause for failure to comply*].

Power to Alter Tables and Forms

Sect. 454.—(1) *The Board of Trade shall have power* by regulations made by statutory instrument *to alter or add to the requirements of this Act as to the matters to be stated in a company's balance sheet, profit and loss account and group accounts, and in particular of those of the Eighth Schedule to this Act* [*reproduced* in extenso *after Sect.* 459 *of the Act*]; and any reference in this Act to the said Eighth Schedule shall be construed as a reference to that Schedule with any alterations or additions made by regulations for the time being in force under this subsection.

(2) *The Board of Trade may* by regulations made by statutory instrument—

(*a*) *alter Table A [part of which is reproduced after Sect.* 8 *of the Act],* . . . *and the form in the Thirteenth Schedule to this Act [reproduced after Sect.* 433 *of the Act]*;

but no alteration made by the Board of Trade in Table A shall affect any company registered before the alteration, or repeal as respects that company any portion of that Table.

(3) No regulations shall be made under subsection (1) of this section so as to render more onerous the requirements therein referred to, unless a draft of the instrument containing the regulations has been laid before Parliament and has been approved by resolution of each House of Parliament.

(4) A statutory instrument containing regulations made under this section, not being regulations to which the last foregoing subsection applies, shall be subject to annulment in pursuance of a resolution of either House of Parliament.

INTERPRETATION

Sect. 455.—(1) In this Act, unless the context otherwise requires, the following expressions have the meanings hereby assigned to them (that is to say)—

"accounts" includes a company's group accounts, whether prepared in the form of accounts or not;

"book and paper" and "book or paper" include accounts, deeds, writings, and documents;

"financial year" means, in relation to any body corporate, the period in respect of which any profit and loss account of the body corporate laid before it in general meeting is made up, whether that period is a year or not;

"group accounts" has the meaning assigned to it by subsection (1) of section one hundred and fifty of this Act;

"holding company" means a holding company as defined by section one hundred and fifty-four of this Act;

"subsidiary" means a subsidiary as defined by section one hundred and fifty-four of this Act;

"Table A" means Table A in the First Schedule to this Act;

EFFECT OF PROVISIONS OF FORMER COMPANIES ACTS AS TO KEEPING BOOKS OF ACCOUNT. 7 Edw. 7. c. 50

Sect. 458.—(2) Subsection (1) of section two hundred and seventy-four of the Companies Act, 1929 (which penalized the persons responsible where proper books of account were not kept by a company throughout the two years immediately preceding the commencement of the winding up) shall be deemed always to have had effect—

(*a*) as if after the words "the period of two years immediately preceding the commencement of the winding-up" there had been inserted the words

"or the period between the incorporation of the company and the commencement of the winding up, whichever is the shorter"; and

(*b*) as if, in the phrase "unless he shows that he acted honestly or that in the circumstances in which the business of the company was carried on the default was excusable," for the word "or" there had been substituted the word "and."

REPEAL AND SAVINGS

Sect. 459.—(13) All funds and accounts constituted under this Act shall be deemed to be in continuation of the corresponding funds and accounts constituted under the former enactments relating to companies.

(14) Nothing in this Act shall affect—

(*a*) the incorporation of any company registered under any enactment hereby repealed;

(*b*) Table B in the Schedule annexed to the Joint Stock Companies Act, 1856, or any part thereof, so far as the same applies to any company existing at the commencement of this Act;

(*c*) Table A in the First Schedule annexed to the Companies Act, 1862, or any part thereof, either as originally contained in that schedule or as altered in pursuance of section seventy-one of that Act, so far as the same applies to any company existing at the commencement of this Act;

(*d*) Table A in the First Schedule to the Companies (Consolidation) Act, 1908, or any part thereof, either as originally contained in that Schedule or as altered in pursuance of section one hundred and eighteen of that Act, so far as the same applies to any company existing at the commencement of this Act;

(*e*) Table A in the First Schedule to the Companies Act, 1929, or any part thereof, so far as the same applies to any company existing at the commencement of this Act.

EIGHTH SCHEDULE

ACCOUNTS

PRELIMINARY

Para. 1. Paragraphs 2 to 11 of this Schedule apply to the balance sheet and 12 to 14 to the profit and loss account, and are subject to the exceptions and modifications provided for by Part II of this Schedule in the case of a holding company and by Part III thereof in the case of companies of the classes there mentioned; and this Schedule has effect in addition to the provisions of sections one hundred and ninety-six and one hundred and ninety-seven of this Act. [*Also see Sect.* 454 *of the Act.*]

PART I

GENERAL PROVISIONS AS TO BALANCE SHEET AND PROFIT AND LOSS ACCOUNT

Balance Sheet

Para. 2. The authorized share capital, issued *share capital, liabilities and assets shall be summarized,* with such particulars as are necessary to disclose the general nature of the assets and liabilities, *and there shall be specified*—

(*a*) *any* part of the issued capital that consists of *redeemable preference shares,* and the earliest date on which the company has power to redeem those shares;

(*b*) so far as the information is not given in the profit and loss account, *any share capital on which interest has been paid out of capital* during the financial year, *and the rate* at which interest has been so paid;

(*c*) the amount of *the share premium account*;

(*d*) particulars of *any redeemed debentures which the company has power to reissue.*

Para. 3. *There shall be stated under separate headings*, so far as they are not written off—

(*a*) the *preliminary expenses*;

(*b*) *any expenses incurred in connection with any issue of* share *capital* or debentures;

(*c*) *any* sums paid by way of *commission in respect of any shares or debentures*;

(*d*) *any* sums allowed by way of *discount in respect of any debentures*; and

(*e*) the amount of *the discount allowed on any issue of shares* at a discount.

Para. 4.—(1) The *reserves, provisions, liabilities and* fixed and current *assets shall be classified under headings* appropriate to the company's business:

Provided that—

(*a*) where the amount of any class is not material, it may be included under the same heading as some other class; and

(*b*) where any assets of one class are not separable from assets of another class, those assets may be included under the same heading.

(2) *Fixed assets shall also be distinguished from current assets.*

(3) The method or *methods used to arrive at the amount of the fixed assets* under each heading *shall be stated.*

Para. 5.—(1) *The method* of arriving at the amount of any fixed asset *shall*, subject to the next following sub-paragraph, *be to take the difference between*—

(*a*) *its cost* or, if it stands in the company's books at a valuation, the amount of the valuation; *and*

(*b*) *the aggregate amount provided* or written off since the date of acquisition or valuation, as the case may be, *for depreciation or diminution in value*; [See (3) below] and for the purposes of this paragraph the net amount at which any assets stand in the company's books at the commencement of this Act (after deduction of the amounts previously provided or written off for depreciation or diminution in value) shall, if the figures relating to the period before the commencement of this Act cannot be obtained without unreasonable expense or delay, be treated as if it were the amount of a valuation of those assets made at the commencement of this Act and, where any of those assets are sold, the said net amount less the amount of the sales shall be treated as if it were the amount of a valuation so made of the remaining assets. [*This paragraph does not apply to investments in Subsidiaries. See para.* 15 (2) (*b*).]

(2) *The foregoing sub-paragraph shall not apply*—

(*a*) *to assets for which the figures* relating to the period beginning with the commencement of this Act *cannot be obtained without unreasonable expense or delay*; or

(*b*) *to assets* the replacement of which is *provided for* wholly or partly—

(i) *by making provisions for renewals* and charging the cost of replacement against the provision so made; [*See* (4) *below*] or

(ii) *by charging the cost of replacement direct to revenue*; or

(*c*) *to any investments of which the market value* (or, in the case of investments not having a market value, their value as estimated by the directors) *is shown* either as the amount of the investments or by way of note; or

(*d*) *to goodwill, patents or trade marks.*

(3) For the assets under each heading whose amount is arrived at in accordance with sub-paragraph (1) of this paragraph, there shall be shown—

(*a*) the aggregate of the amounts referred to in paragraph (*a*) of that sub-paragraph; and

(*b*) the aggregate of the amounts referred to in paragraph (*b*) thereof.

(4) As respects the assets under each heading whose amount is not arrived at in accordance with the said sub-paragraph (1) because their replacement is provided for as mentioned in sub-paragraph (2) (*b*) of this paragraph, there shall be stated—

(*a*) the means by which their replacement is provided for; and

(*b*) the aggregate amount of the provision (if any) made for renewals and not used.

Para. 6. The aggregate amounts respectively of *capital reserves, revenue reserves and provisions* (other than provisions for depreciation, renewals or diminution in value of assets) *shall be stated under separate headings*: [But see para. 12 (2).]

Provided that—

(*a*) this paragraph *shall not require* a separate statement of any of the said three *amounts which is not material*; and

(*b*) the *Board of Trade may direct that it shall not require* a separate statement of *the amount of provisions* where they are satisfied that that is not required in the public interest and would prejudice the company, but subject to the condition that any heading stating an amount arrived at after taking into account a provision (other than as aforesaid) shall be so framed or marked as to indicate that fact.

Para. 7.—(1) There shall also be shown (unless it is shown in the profit and loss account or a statement or report annexed thereto, or the amount involved is not material)—

(*a*) *where the amount* of the capital reserves, of the revenue reserves or of the provisions (other than provisions for depreciation, renewals or diminution in value of assets) *shows an increase* as compared with the amount at the end of the immediately preceding financial year, *the source from which the amount of the increase has been derived*; and

(*b*) *where*—

(i) *the amount* of the capital reserves or of the revenue reserves *shows a decrease* as compared with the amount at the end of the immediately preceding financial year; or

(ii) the amount at the end of the immediately preceding financial year of the provisions (other than provisions for depreciation, renewals or diminution in value of assets) exceeded the aggregate of the sums since applied and amounts still retained for the purposes thereof;

the application of the amounts derived from the difference. [See para. 12 (1) (*f*), and (2).]

(2) Where the heading showing any of the reserves or provisions aforesaid is divided into sub-headings, this paragraph shall apply to each of the separate amounts shown in the sub-headings instead of applying to the aggregate amount thereof.

Para. 8.—(1) *There shall be shown under separate headings*—

(*a*) the aggregate amounts respectively of the company's *trade investments, quoted investments* other than trade investments and *unquoted investments* other than trade investments; [*See para.* 15 *re subsidiaries.*]

(*b*) if the amount of *the goodwill and of any patents and trade-marks* or part of that amount is shown as a separate item in or is otherwise ascertainable from the books of the company, or from any contract for the sale or purchase of any property to be acquired by the company, or from any documents in the possession of the company relating to the stamp duty payable in respect of any such contract or the conveyance of any such property, the said amount so shown or ascertained so far as not written off or, as the case may be, the said amount so far as it is so shown or ascertainable and as so shown or ascertained, as the case may be; [*See* (2) *below.*]

(*c*) the aggregate amount of any outstanding *loans* made under the authority of provisos (*b*) and (*c*) of subsection (1) of section fifty-four of this Act;

(*d*) the aggregate amount of *bank loans and overdrafts*;

(*e*) the net aggregate amount (after deduction of income tax) which is *recommended* for distribution by way of *dividend.*

(2) Nothing in head (*b*) of the foregoing sub-paragraph shall be taken as requiring the amount of the *goodwill, patents and trade-marks to be stated* otherwise than *as a single item.*

(3) The heading showing the amount of the *quoted investments* other than trade investments shall be subdivided, where necessary, *to distinguish* the investments as respects *which there has, and* those as respects *which there has not, been granted a quotation or permission to deal on a recognized stock exchange.* [See para. 28.]

Para. 9. Where *any liability* of the company is *secured otherwise than by operation of law on any assets* of the company, the fact that that liability is so secured shall be stated, but it shall not be necessary to specify the assets on which the liability is secured.

Para. 10. *Where any of the company's debentures are held by a nominee of or trustee for the company*, the nominal amount of the debentures and the amount at which they are stated in the books of the company shall be stated.

Para. 11.—(1) The matters referred to in the following sub-paragraphs shall be *stated by way of note, or in a statement or report annexed*, if not otherwise shown.

(2) The number, description and amount of any *shares in the company which any person has an option to subscribe for*, together with the following particulars of the option, that is to say—

(*a*) the period during which it is exercisable;

(*b*) the price to be paid for shares subscribed for under it.

(3) The amount of any *arrears of fixed cumulative dividends* on the company's shares and the period for which the dividends or, if there is more than one class, each class of them are in arrear, the amount to be stated before deduction of income tax, except that, in the case of tax free dividends, the amount shall be shown free of tax and the fact that it is so shown shall also be stated.

(4) Particulars of *any charge on the assets of the company to secure the liabilities of any other person*, including, where practicable, the amount secured.

(5) The general nature of any other *contingent liabilities* not provided for and, where practicable, the aggregate amount or estimated amount of those liabilities, if it is material.

(6) Where practicable the aggregate amount or estimated amount, if it is material, of *contracts for capital expenditure*, so far as not provided for.

(7) If in the opinion of the directors *any of the current assets have not a value, on realization* in the ordinary course of the company's business, *at least equal to the amount at which they are stated*, the fact that the directors are of that opinion.

(8) The aggregate *market value of the company's quoted investments*, other than trade investments, where it differs from the amount of the investments as stated, and the stock exchange value of any investments of which the market value is shown (whether separately or not) and is taken as being higher than their stock exchange value.

(9) *The basis on which foreign currencies have been converted into sterling*, where the amount of the assets or liabilities affected is material.

(10) *The basis on which* the amount, if any, set aside for United Kingdom *income tax is computed*.

(11) Except in the case of the first balance sheet laid before the company after the commencement of this Act, *the corresponding amounts at the end of the immediately preceding financial year* for all items shown in the balance sheet.

Profit and Loss Account

Para. 12.—(1) *There shall be shown*—

(*a*) *the amount charged to revenue by way of provision for depreciation, renewals or diminution in value of fixed assets*[1];

(*b*) the amount of the *interest on* the company's *debentures and other fixed loans*;

(*c*) the amount of the charge for *United Kingdom income tax and other United Kingdom taxation on profits*, including, where practicable, as United Kingdom income tax any taxation imposed elsewhere to the extent of the relief, if any, from United Kingdom income tax and distinguishing where practicable between income tax and other taxation;

(*d*) the *amounts* respectively *provided for redemption of share capital and* for redemption of *loans*;

(*e*) *the amount*, if material, *set aside* or proposed to be set aside *to, or withdrawn from, reserves*;

(*f*) subject to sub-paragraph (2) of this paragraph, *the amount*, if material, *set aside to provisions* other than provisions for depreciation, renewals or diminution

[1] This does not apply to investments in subsidiaries. See para. 15 (2) (*b*).

in value of assets or, as the case may be, the amount, if material, *withdrawn from such provisions* and not applied for the purposes thereof;

(*g*) the amount of *income from* investments, distinguishing between *trade investments and other investments*;

(*h*) the aggregate amount of the *dividends paid* and proposed.

(2) The Board of Trade may direct that a company shall not be obliged to show an amount set aside to provisions in accordance with sub-paragraph (1) (*f*) of this paragraph, if the Board is satisfied that that is not required in the public interest and would prejudice the company, but subject to the condition that any heading stating an amount arrived at after taking into account the amount set aside as aforesaid shall be so framed or marked as to indicate that fact. [*See paras.* 6 *and* 7.]

Para. 13. If *the remuneration of the auditors* is not fixed by the company in general meeting, the amount thereof *shall be shown under a separate heading*, and for the purposes of this paragraph, *any* sums paid by the company in respect *of the auditors' expenses shall be deemed to be included in the expression "remuneration."*

Para. 14.—(1) The matters referred to in *the following* sub-paragraphs *shall be stated by way of note, if not otherwise shown.*

(2) *If depreciation or replacement of fixed assets is provided for by some method other than a depreciation charge* or provision for renewals, or is not provided for, *the method by which it is provided for or* the fact that it *is not provided for*, as the case may be.[1]

(3) The *basis on which the charge for United Kingdom income tax is computed.*

(4) *Whether* or not the amount stated for *dividends* paid and proposed is for dividends *subject to deduction of income tax.*

(5) Except in the case of the first profit and loss account laid before the company after the commencement of this Act *the corresponding amounts for the immediately preceding financial year* for all items shown in the profit and loss account.

(6) Any material respects in which any items shown in the profit and loss accounts are affected—

(*a*) by *transactions* of a sort not usually undertaken by the company or otherwise by circumstances *of an exceptional or non-recurrent nature;* or

(*b*) by *any change in the basis of accounting.*

Part II

SPECIAL PROVISIONS WHERE THE COMPANY IS A HOLDING OR SUBSIDIARY COMPANY

Modifications of and Additions to Requirements as to Company's own Accounts

Para. 15.—(1) *This paragraph shall apply where the company is a holding company*, whether or not it is itself a subsidiary of another body corporate.

(2) The aggregate amount of *assets consisting of shares in, or amounts owing* (whether on account of a loan or otherwise) *from*, the company's *subsidiaries*, distinguishing shares from indebtedness, *shall be set out* in the balance sheet *separately from* all the *other assets* of the company, *and the aggregate amount of indebtedness* (whether on account of a loan or otherwise) *to* the company's *subsidiaries* shall be so set out *separately from* all its *other liabilities* and—

(*a*) the references in Part I of this Schedule to the company's investments shall not include investments in its subsidiaries required by this paragraph to be separately set out; and

(*b*) paragraph 5, sub-paragraph (1) (*a*) of paragraph 12, and sub-paragraph (2) of paragraph 14 of this Schedule shall not apply in relation to fixed assets consisting of interests in the company's subsidiaries.

(3) *There shall be shown* by way of note on the balance sheet or *in a statement or report* annexed thereto the number, *description* and amount *of the shares in and debentures of the company held by its subsidiaries* or their nominees, but excluding any of those shares or debentures in the case of which the subsidiary is concerned as

[1] This does not apply to investments in subsidiaries. See para. 15 (2) (*b*).

personal representative or in the case of which it is concerned as trustee and neither the company nor any subsidiary thereof is beneficially interested under the trust, otherwise than by way of security only for the purposes of a transaction entered into by it in the ordinary course of a business which includes the lending of money.

(4) *Where group accounts are not submitted,* there shall be annexed to the balance sheet *a statement showing*—

(*a*) *the reasons why* subsidiaries are *not* dealt with in *group accounts*:

(*b*) *the net aggregate amount,* so far as it concerns members of the holding company and is *not dealt with* in the company's accounts, *of the subsidiaries' profits after deducting* the subsidiaries' *losses* (or vice versa)—

(i) for the respective financial years of the subsidiaries ending with or during the financial year of the company; and

(ii) for their previous financial years since they respectively became the holding company's subsidiary; [*but see* (5) *below*]

(*c*) *the net aggregate amount of the subsidiaries' profits* after deducting the subsidiaries' *losses* (or vice versa)—

(i) for the respective financial years of the subsidiaries ending with or during the financial year of the company; and

(ii) for their other financial years since they respectively became the holding company's subsidiary;

so far as those profits are dealt with, or provision is made for those losses, *in the company's accounts*; [but see (5) below.]

(*d*) *any qualifications contained in the report of the auditors of the subsidiaries* on their accounts for their respective financial years ending as aforesaid, *and any note or saving contained in those accounts* to call attention to a matter which, apart from the note or saving, would properly have been referred to in such a qualification, in so far as the matter which is the subject of the qualification or note is not covered by the company's own accounts and is material from the point of view of its members;

or, in so far as the information required by this sub-paragraph is not obtainable, *a statement that it is not obtainable*;

Provided that *the Board of Trade may,* on the application or with the consent of the company's directors, *direct that* in relation to any subsidiary *this sub-paragraph shall not apply* or shall apply only to such extent as may be provided by the direction.

(5) Paragraphs (*b*) and (*c*) of the last foregoing sub-paragraph shall apply only to profits and losses of a subsidiary which may properly be treated in the holding company's accounts as revenue profits or losses, and the profits or losses attributable to any shares in a subsidiary for the time being held by the holding company or any other of its subsidiaries shall not (for that or any other purpose) be treated as aforesaid so far as they are profits or losses for the period before the date on or as from which the shares were acquired by the company or any of its subsidiaries, except that they may in a proper case be so treated where—

(*a*) the company is itself the subsidiary of another body corporate; and

(*b*) the shares were acquired from that body corporate or a subsidiary of it;

and for the purpose of determining whether any profits or losses are to be treated as profits or losses for the said period the profit or loss for any financial year of the subsidiary may, if it is not practicable to apportion it with reasonable accuracy by reference to the facts, be treated as accruing from day to day during that year and be apportioned accordingly.

(6) Where group accounts are not submitted, there shall be annexed to the balance sheet a statement showing, in relation to the subsidiaries (if any) whose financial years did not end with that of the company—

(*a*) the reasons why the company's directors consider that the subsidiaries' financial years should not end with that of the company; and

(*b*) the dates on which the subsidiaries' financial years ending last before that of the company respectively ended or the earliest and latest of those dates.

Para. 16.—(1) The balance sheet of a company which is a *subsidiary* of another

body corporate, whether or not it is itself a holding company, *shall show the aggregate amount of its indebtedness to all bodies corporate of which it is a subsidiary or a fellow subsidiary and the aggregate amount of the indebtedness* of all such bodies corporate *to it*, distinguishing in each case between indebtedness in respect of debentures and otherwise.

(2) For the purposes of this paragraph a company shall be deemed to be a fellow subsidiary of another body corporate if both are subsidiaries of the same body corporate but neither is the other's.

Consolidated Accounts of Holding Company and Subsidiaries

Para. 17. Subject to the following paragraphs of this Part of this Schedule, the *consolidated balance sheet and profit and loss account shall combine the information contained in the separate balance sheets and profit and loss accounts of the holding company and of the subsidiaries* dealt with by the consolidated accounts, but with such adjustments (if any) as the directors of the holding company think necessary.

Para. 18. Subject as aforesaid and to Part III of this Schedule, *the consolidated accounts shall*, in giving the said information, *comply*, so far as practicable, *with the requirements of this Act as if they were the accounts of an actual company.*

Para. 19. Sections one hundred and ninety-six and one hundred and ninety-seven of this Act shall not, by virtue of the two last foregoing paragraphs, apply for the purpose of the consolidated accounts. [I.e. *Directors' salaries and pensions, and loans to officers need not be shown.*]

Para. 20. Paragraph 7 of this Schedule shall not apply for the purpose of any consolidated accounts laid before a company with the first balance sheet so laid after the commencement of this Act.

Para. 21. In relation to any subsidiaries of the holding company not dealt with by the consolidated accounts—

(*a*) sub-paragraphs (2) and (3) of paragraph 15 of this Schedule shall apply for the purpose of those accounts as if those accounts were the accounts of an actual company of which they were subsidiaries; and

(*b*) there shall be annexed the like statement as is required by sub-paragraph (4) of that paragraph where there are no group accounts, but as if references therein to the holding company's accounts were references to the consolidated accounts.

Para. 22. In relation to *any subsidiaries* (whether or not dealt with by the consolidated accounts), *whose financial years did not end with that of the company, there shall be annexed the like statement as is required by sub-paragraph* (6) *of paragraph* 15 of this Schedule where there are no group accounts.

PART III

EXCEPTIONS FOR SPECIAL CLASSES OF COMPANY

Para. 23.—(1) *A banking or discount company* shall not be subject to the requirements of Part I of this Schedule other than—

(*a*) as respects its balance sheet, those of paragraphs 2 and 3, paragraph 4 (so far as it relates to fixed and current assets), paragraph 8 (except sub-paragraph (1) (*d*)), paragraphs 9 and 10, and paragraph 11 (except sub-paragraph (8)); [*This permits the non-disclosure on the balance sheet of the method of arriving at fixed assets, the transfer to and from reserves and provisions, the bank loans and overdrafts, and the market values of quoted investments.*] and

(*b*) as respects its profit and loss account, those of sub-paragraph (1) (*h*) of paragraph 12, paragraph 13 and sub-paragraphs (1), (4) and (5) of paragraph 14; [*This permits the non-disclosure on the profit and loss account of all details except the dividends paid and proposed, the auditors' remuneration, the tax deducted from dividends, and the corresponding figures for last year.*]

but, where in its balance sheet capital reserves, revenue reserves or provisions (other than provisions for depreciation, renewals or diminution in value of assets) are not stated separately, any heading stating an amount arrived at after taking into account such a reserve or provision shall be so framed or marked as to indicate that fact, and its profits and loss account shall indicate by appropriate words the manner in which the amount stated for the company's profit or loss has been arrived at.

(2) The accounts of a banking or discount company shall not be deemed, by reason only of the fact that they do not comply with any requirements of the said Part I from which the company is exempt by virtue of this paragraph, not to give the true and fair view required by this Act.

(3) In this paragraph the expression "banking or discount company" means any company which satisfies the Board of Trade that it ought to be treated for the purposes of this Schedule as a banking company or as a discount company.

Para. 24.—(1) In relation to *an assurance company* within the meaning of the Assurance Companies Acts, 1909 to 1946, which is subject to and complies with the requirements of those Acts as respects the preparation and deposit with the Board of Trade of a balance sheet and profit and loss account, the foregoing paragraph shall apply as it applies in relation to a banking or discount company, and such an assurance company shall also not be subject to the requirements of sub-paragraphs (1) (*a*) and (3) of paragraph 8 and sub-paragraphs (4) to (7) and sub-paragraph (10) of paragraph 11 of this Schedule: [*This permits the same non-disclosure as for a banking or discount company, but also allows non-disclosure of capital contracts, charges on assets, contingent liabilities, realizable value of current assets (where less than stated value), and basis of computing U.K. income tax.*]

Provided that the Board of Trade may direct that any such assurance company whose business includes to a substantial extent business other than assurance business shall comply with all the requirements of the said Part I or such of them as may be specified in the direction and shall comply therewith as respects either the whole of its business or such part thereof as may be so specified.

(2) Where an assurance company is entitled to the benefit of this paragraph, then any wholly owned subsidiary thereof shall also be so entitled if its business consists only of business which is complementary to assurance business of the classes carried on by the assurance company.

(3) For the purposes of this paragraph a company shall be deemed to be the wholly owned subsidiary of an assurance company if it has no members except the assurance company and the assurance company's wholly owned subsidiaries and its or their nominees.

Para. 25.—(1) A company to which this paragraph applies shall not be subject to the following requirements of this Schedule, that is to say—

(*a*) as respects its balance sheet, those of paragraph 4 (except so far as the said paragraph relates to fixed and current assets) and paragraphs 5, 6 and 7; [*i.e. regarding non-disclosure on balance sheet of details of reserves, method of arriving at fixed assets, and transfers to and from reserves.*] and

(*b*) as respects its profit and loss account, those of sub-paragraph (1) (*a*), (*e*) and (*f*) of paragraph 12; [i.e. *regarding non-disclosure on profit and loss account of details of depreciation, and transfers to and from reserves and provisions*]

but a company taking advantage of this paragraph shall be subject, instead of the said requirements, to any prescribed conditions as respects matters to be stated in its accounts or by way of note thereto and as respects information to be furnished to the Board of Trade or a person authorized by them to require it.

(2) The accounts of a company shall not be deemed, by reason only of the fact that they do not comply with any requirements of Part I of this Schedule from which the company is exempt by virtue of this paragraph, not to give the true and fair view required by this Act.

(3) *This paragraph applies to companies of any class prescribed for the purposes thereof*, and a class of companies may be so prescribed if it appears to the Board of Trade desirable in the national interest:

Provided that, if the Board of Trade are satisfied that any of the conditions prescribed for the purposes of this paragraph has not been complied with in the case of any company, they may direct that so long as the direction continues in force this paragraph shall not apply to the company.

Para. 26. Where a company entitled to the benefit of any provision contained in this Part of this Schedule is a holding company, the reference in Part II of this Schedule to consolidated accounts complying with the requirements of this Act shall, in relation to consolidated accounts of that company, be construed as referring to those requirements in so far only as they apply to the separate accounts of that company.

PART IV

INTERPRETATION OF SCHEDULE

Para. 27.—(1) For the purposes of this Schedule, unless the context otherwise requires,—

(*a*) *the expression "provision" shall*, subject to sub-paragraph (2) of this paragraph, *mean* any amount written off or retained by way of providing for depreciation, renewals or diminution in value of assets or retained by way of providing for any known liability of which the amount cannot be determined with substantial accuracy;

(*b*) *the expression "reserve" shall not*, subject as aforesaid, *include* any amount written off or retained by way of providing for depreciation, renewals or diminution in value of assets or retained by way of providing for any known liability;

(*c*) *the expression "capital reserve" shall not include* any amount regarded as free for distribution through the profit and loss account and *the expression "revenue reserve" shall mean* any reserve other than a capital reserve;

and in this paragraph *the expression "liability" shall include* all liabilities in respect of expenditure contracted for and all disputed or contingent liabilities.

(2) *Where*—

(*a*) *any amount written off or retained by way of providing for depreciation*, renewals or diminution in value of assets, not being an amount written off in relation to fixed assets before the commencement of this Act; or

(*b*) *any amount retained by way of providing for any known liability*;

is in excess of that which in the opinion of the directors is reasonably necessary for the purpose, *the excess shall be treated for the purposes of this Schedule as a reserve and not as a provision.*

Para. 28. For the purposes aforesaid, *the expression "quoted investment" means* an investment as respects which there has been granted a quotation or permission to deal on a recognized stock exchange, or on any stock exchange of repute outside Great Britain, and the expression "*unquoted investment*" shall be construed accordingly.

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